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CHARACTERISTICS OF MACROECONOMIC TRENDS IN THE FIRST SIX MONTHS OF 2003

General Overview

According to available statistical data, total economic activity is estimated to have increased by about 3.5% - 4% in real terms in the first six month of 2003 year-to-year. Significant growth was registered in transport, trade and construction, while all other sectors recorded a drop in real terms

With regard to the decrease in industrial and agricultural output, significant real growth in services indicates that private sectors of production and services, which are not covered by official statistics, generate a considerable level of activity.

According to our assessments, a low level of total economic activity, closely related to the fall in industrial production, result to a significant extent from tardiness in the process of privatization and enterprises restructuring, in particular in the industry, as compared with the projected rates.

The labor market displayed negative trends: a decreasing number of the employed and a rise in registered employment. The total number of active firms declined, while the number of small start-ups which employ about 5 workers, on average, slightly increased. If the current pace of starting up new small companies continues, given the above mentioned number of employees per a company, it would take, according to our estimations, about 28 years to create jobs for one million persons. We underline that in the last two years, as well as in the course of the first few months of 2003, only small-sized companies have started up, which indicates not only the lack of capital, but also that entrepreneurs are very wary of the continual political instability in our country.

Total private consumption registered intensive growth, as compared with both the real increase in supply and real growth in the average real wages and average real pension. This indicates that: (1) consumption continues to exceed production and productivity; and (2) that income from work does not account for the most significant portion in the structure of household income, whereby other income

sources – e.g. property, gray economy, natural consumption, remittances from foreign countries, etc. – seem to be much more relevant.

Such trends in final consumption threaten to compromise development, because the volume of private consumption is exaggerated, not leaving enough room for investments from gross domestic product. It is hard to believe that serious foreign investors would decide to invest in a country which thus demonstrates its lack of orientation towards investments and development.

Serbian exports increased substantially in the first six month of 2003, but, on the other hand, the dynamics of import growth were much more intensive than projected, resulting in a wider trade deficit. In the first five months, commodity exports were nominally up by 29%, year-to-year; commodity imports rose by 33%, thus increasing the trade deficit by nearly half a billion of nominal US$, which exceeds total commodity exports by as much as 85%.

The results of our analyses indicate that any significant increase and improvement of competitiveness of the Serbian exports is not very likely without thorough restructuring and improvement of the managing of existing enterprises, as well as without more intensive increase in the number of start-ups and FDI inflow.

Social policy also recorded positive trends. It has been gradually removed from enterprises, with the Government taking over functions in this area. Following the adoption of a National Poverty Reduction Strategy, and with international financial assistance, projects of a developmental character are expected to start. These projects will be primarily directed at job creation and education programs designed to improve and update skills of the unemployed for the sake of their easier employment.

Public revenues on the basis of taxes and contributions collected in the period January – June 2003 increased by 17.3%; both the collection of taxes and of social insurance contributions registered similar dynamics of growth (by 17.1% and 17.8% respectfully).

A worrisome development is that revenues on the basis of social insurance contributions were growing much slower in nominal terms than the mass of paid wages and salaries (by about 6 percentage points). This indicates lower efficiency in the collection of social insurance contributions after the restructuring of ZOP (Payment and Settlement Bureau), when this activity was transferred to the Ministry of Finance of the Republic of Serbia.

Production and Services

Available statistical data implies a sharp decline in industrial production in Serbia in the first six month of 2003, year-to-year. Such a trend to a great extent resulted from the drop in industrial production registered in January 2003, relative to December 2002, considerably decelerated growth in March relative to February, and month-on-month stagnation in the period April – June.

Industrial production in Serbia, without Kosovo and Metohija, registered a 3.1% drop in the period January-June, year-to-year, or by 6.5% compared to the 2002 average.

With regard to sectors of industrial production, mining and quarrying decreased by 5.9% and manufacturing by 4.8%, while the sector of energy, gas and water production and supply was up by 3.2% in the first six months of 2003 year-to-year.

By destination of consumption, the production of capital goods was down by 19.9%, the production of intermediate goods decreased by 1.1%, while the production of consumer goods dropped by 4.1%.
A year-to-year drop in industrial production in the first half of 2003 was more intensive in Central Serbia (-4.3%) than in Vojvodina (-0.8%).
In the sector of manufacturing, only several groups registered growth in output in the period January – June 2003 year-to-year: the manufacture of coke and refined petroleum products (22.6%), the manufacture of chemicals and chemical products (12.6%), the manufacture of basic metals (7.2%), the manufacture of rubber and plastic products (2.6%), publishing, printing and reproduction (1.9%) and recycling (1.4%). The decrease registered in other industries ranges from -44.5% in the manufacture of clothing and fur through -1.9% in the manufacture of food products and beverages.
The value of construction works realized in the first quarter of this relative to the same period last year rose by 14% in real terms. Transport is also estimated to have increased substantially during this period. The total freight transport, measured in ton kilometers, was up by 88%, while passenger transport dropped off by about 20%; the result is growth in the total transport volume by about 40%. Retail trade turnover in the period January – May 2003 increased by 18% year-to-year. The turnover in catering industry showed a downward trend – it was down by 6.9% in real terms in the first five months of this year relative to the same period in 2002. The turnover in tourism also fell by 3.0% in the first quarter of 2003.

Labor Market

The labor market in Serbia registered a downward trend in the period January-May. Total employment in Serbia in the first five months of 2003 dropped by 3% year-to-year. Total registered unemployment in May 2003 stood at 951,270 persons, 18.2% year-to-year increase, while regarding the period January – May 2003 it increased by 17.5%. The unemployment rate in May 2003 was 32%, being at the same level as in the previous month, as compared to the 27.9% unemployment rate registered in May 2002.
However, significant changes occurred with regard to the structure of total employment in terms of the ownership structure of enterprises. The number of employees in the socially-owned sector has been decreasing month after month, being down by 7.2% in the period January-May. Employment in the private sector in May 2003 rose by 10.6% month-on-month, or by 4.2% relative to December 2002. The number of employees in small-sized enterprises in May rose by 3.5% month-on-month, or by 1.1% compared to December 2002.
The total number of new jobs in the period January – May 2003 stood at 168 thousand, a year-to-year drop by 1.1%. The number of terminations in the same period decreased by 3.4. As far as the structure of employment is concerned, a larger share of fluctuation in total employment indicates decreasing rigidity of the labor market. Fluctuation in the first five months of 2003 was up by 19.6% relative to the same period last year, accounting for 42.9% in the total of new jobs, while the remainder refers to persons previously registered as unemployed with the Labor Market Bureau.

According to the data of the Labor Market Bureau, the number of job openings (labor demand) in the period January-May 2003 decreased by 0.4% year-to-year, and therefore the demand for labor (the ratio of the total number of the employed in the period under consideration to the number of vacancies) is fulfilled by 84%.

According to the data released by the Federal Statistics Bureau, the number of start-ups in the first quarter of 2003 is 3,389, 91.6% of which are private companies, with the majority of them being small-sized firms. In 2002 there were 6,893 start-ups, 92.4% in private ownership, all of them being small-sized companies.

It is interesting that in last two years there were more state-owned companies, although, expressed in percentage points, their share was rather small, indicating that big state-owned companies are at issue. The portion of the employed in the state-owned companies significantly increased (11% in 2002 relative to 6.8% in 2000). This indicates that in these companies the process of restructuring has not started yet, while changes in companies of other forms of ownership are notable, which increases their relative share both in terms of the number of enterprises and the number of employees.

During the last two years, as well as in the first several months of this year, over 90% of startups were in private ownership, all of them being small-size companies. Over 90% of new jobs during this period were created in these companies. Since 2001, new small-sized private companies constitute 92%, on average, of the total number of start-ups.

This is a consequence of changed legal regulations and simplified procedure for registering companies.

The data on the number of small start-ups and the number of employees in them in the last two years indicates that these companies employ about 35,000 persons a year. Given the pace of opening new firms and the number of the employed in such firms in the previous two years, it would take nearly 30 years to achieve the goal promoted by the Government, i.e. one million new jobs in small-sized enterprises. The Government of Serbia obviously does not possess relevant information on trends in the entrepreneurship and on the labor market. Namely, the goal itself is very desirable given the high level of both registered and hidden unemployment, but in order to realize this idea in practice in an acceptable, shorter period, the Government's measures and mechanisms are necessary to encourage entrepreneurship and job creation. Among other things, the Government must find ways to attract more FDIs, as well as to motivate domestic employers to invest more in job creation.

Features of Domestic Demand

On the basis of developments in retail trade, real growth in personal consumption in the first six months of 2003 is estimated at about 18% year-to-year, which is significantly above the estimated GDP growth. High growth of real domestic demand continues to generate much faster increase in real wages of the employed compared to production and productivity.

The average net wage in Serbia in the period January-May 2003 was YuD 10,427, a rise of 27.4% year-to-year in nominal terms, or 13.75% in real terms. The average net wage paid out in May was YuD 11,043, a nominal decrease of

0.94% compared with previous month; in real terms, given the 0.4% increase in costs of living relative to April, the average net wage fell by 1.34%.

The real purchasing power of citizens of Serbia in the first six months of this year significantly increased relative to the same period the year earlier in spite of monthly variations in nominal wages. The average consumer basket for a four-member family in the period January-May 2003 was valued at YuD 11,220, or 1.1 wages. Compared to the ratio of consumer basket and the average net wage of 1.35 registered in the same period last year, today, this indicator is lower by 20%.

The average net wage paid out in the economy in the period January-May was nominally up by 25.35% or by 12% in real terms year-to-year. As far as non-economic activity is concerned, the average net wage nominally increased by 31.56% or by 17.5% in real terms.

With regard to individual industries, the most intensive real growth in the period under consideration was registered in the sector of insurance (by 52%), real estate activities (by 50%) and other services (44.7%). The sharpest drop in wages was registered in the renting of machinery and equipment (by 42.1%), the manufacture of clothing and fur (by 21.2%) and the mining of metal ores (by 16.9%).

The average pension paid put by the Old Age Pension and Disability Fund of the Employed in the period January-June 2003 increased by 23.1% nominally, or by 7.5% in real terms. The average pension paid out in June was up by 8.1% relative to December 2002.

The purchasing power of pensioners during the period under consideration improved. The share of the consumer basket per family member in the average pension paid out in the first five months of 2003 equaled 36.6%, compared to 44.1% the year earlier, i.e. a decrease of 17%.

According to the presented figures, a year-to-year increase in the purchasing power of pensioners in the first six months of 2003 is slightly slower than the increase in the purchasing power of the employed.

Social Policy

The area of social policy has registered positive developments. Social functions are gradually being removed from enterprises and transferred to the Government.

At the beginning of 2003, the new Law on Old-Age Pension and Disability Insurance was adopted. It came into force as of April 2. The Law introduced a new formula for the determination of pensions, which is aimed at approximating the value of a pension to the amount of pension insurance contributions made during the working period.

The Draft Law on Modifications and Amendments to the Law on Health Insurance has been prepared. It is now waiting to enter parliamentary procedure.

The Government adopted the draft of the National Poverty Reduction Strategy. The PRS was created in cooperation with domestic and foreign experts, representatives of the Government and local and international NGOs. The PRS is development-based, implying that the major part of the resources allocated for the realization of the strategy will be directed toward job creation and educational programs; indirectly, through the increase of the total mass of paid wages and taxes and contributions, the Strategy will provide resources for financing social programs and deprived citizens.

We assess the relation between social partners on the labor market, i.e. trade unions, the Union of Employers and the Government as still being tense and dysfunctional. Trade unions, which are of great importance for social dialogue, seem to be especially disharmonious today. Therefore, besides the necessity for the membership of certain social partners to press their leaderships to focus on creating conditions for development and job creation, and greater flexibility in negotiations, it is also necessary to provide education for representatives of certain social partners on social dialogue in societies in transition toward democracy and market economy, and on the constructive role that social partners should have in that process.

Privatization and Restructuring of the Economy

Today it has been two years since the Privatization Law was adopted and since the privatization process has started under the new regulations. With regard to the time anticipated for privatization of the socially-owned and state-owned capital of the Serbian economy, we have reached the halfway point. The privatization method set up under the Privatization Law foresees 1) the sale of majority packages of shares, in public tender or public auction (up to 70% of assets); 2) transfer of socially-owned and state-owned capital free of charge in two ways: transfer of shares to employees in the entity undergoing privatization, and the transfer of capital to all citizens (up to the remaining 30%); and 3) restructuring of those enterprises that record negative operating results, are not able to fulfill their liabilities, or have organizational or age structures inappropriate for successful privatization. Basic principles embodied in this Law are publicity, transparency and competitiveness, as well as a limited time framework for completion – all socially-owned legal entities must be privatized within four years (until June 2005). However, the privatization process progresses quite slowly and it is unlikely to be completed in the prescribed period.

Until the beginning of July 2003, 22 big enterprises were sold in tender (of the total of 130 enterprises foreseen for privatization), and 604 small and medium enterprises (of the total of 6,000) were sold in 72 public auctions. In 2003 only, ten big enterprises were sold in tender, and 398 small and medium enterprises (of projected 1,000) were sold in 38 public auctions. Privatization receipts realized so far total about EUR 560 million, of which EUR 218 million were realized in 2003. Out of this sum, 10% are to be transferred to pension funds, 5% are reserved for funding the state's obligations on the basis of restitution, one portion will be spent on incentives for small and medium enterprises, another portion is to be earmarked for social programs, etc., in accordance with the Government's economic policies.

In the first six months of 2003, the pace of auction privatization was faster than the year earlier. However, given that only 10% of the total number of companies projected to be sold in auctions has been actually privatized so far, the entire process must be accelerated. Faster privatization would make possible for small and medium enterprises and private entrepreneurs to constitute the majority of all economic entities, thus being one of the key sources of jobs, as is the case in the economies of developed countries,.

Auction privatization is by definition transparent and public, ensuring clear and evident competition between potential buyers. However, with regard to tender

privatization, the most frequent criticism refers to the lack of transparency. Namely, privatization is carried out by public tender when a company meets criteria in terms of its size (big enterprises), strategic significance and buyers' interests. There are four criteria for ranking participants in the tender (price; future investments; social program; environmental protection program), and for this reason final selection of the best buyer depends on non-market criteria, as well. Many believe that the decision on the best bid should be based on one criterion only, i.e. the price offered, in line with practices in developed countries. Otherwise, offers are not comparable, there is purchasing of social peace in some way, while the state shows that it is not ready yet to accept its social function, trying to pass a portion of its social responsibility onto new owners. In the area of environmental protection, new owners are required to assess and cover environmental protection costs, but since these costs result from the absence of measures in this area from the past, foreign buyers therefore want to shift responsibility for them to the state.

There are 50 insolvent and heavily indebted big socially-owned complexes identified in our economy, with many subsidiaries and a large number of workers. It is not possible to privatize these companies without previous financial and corporate restructuring, which is a long and thorough process. It is projected that 33 companies will commence the procedure in 2003, among which there will be some public enterprises, as well. The Government pays special attention to the creation of social programs for workers that will become redundant. Namely, social programs will be supported from the transition fund, which has a clear and strict budgetary position, which enabled the completion of the restructuring process in 20 companies in 2002 as far as the social program is concerned. In spite of the complexity of the process, it is anticipated to be completed within the next 24 months.

Cooperation with International Financial Organizations

The Governments of Serbia and Montenegro agreed that the National Bank of Serbia will perform the duty of the fiscal agent in the International Monetary Fund, while the Central Bank of Montenegro will act as a fiscal agent in the World Bank.

As a result of the agreement of the two governments and the adoption of the Constitutional Charter, in April, after the delay of several months, the International Monetary Fund released the third and fourth installments of the Extended Fund Facility (EFF) in the total amount of about US$ 137 million (SDR 100 million).

The World Bank has granted Serbia three credits in 2003: the second Private and Financial Sector Adjustment Credit (PFSAC) in the amount of US$ 60 million, a credit for health sector reform (US$ 20 million) and the Social Sector Adjustment Credit (SOSAC) in the amount of US$ 80 million. All these credits have been approved under IDA conditions, which means a grace period of ten years and twenty-year maturity.

Exchange Rate and Foreign Currency Reserves

Throughout the first half of 2003, the exchange rate was showing slightly more intensive nominal depreciation relative to the previous months. In the mid-2003, the exchange rate of the dinar against the euro nominally depreciated by 6% relative to December 2002, or by 8% year-to-year. Given the slower growth in prices, the exchange rate has started displaying a mild, but permanent real depreciation as of beginning of the year, for the first time after many months.
Developments on the foreign exchange market did not have any significant impact on foreign trade because, in spite of the depreciation of the exchange rate, the trade deficit continued to grow. Such a trend is not surprising since the G 17 Institute analysis showed several times that the foreign exchange rate is not a significant determinant of commodity exports and imports in our country.
Foreign exchange reserves in the National Bank of Serbia reached nearly US$ 2.5 billion in the mid-2003, which covers Serbia's imports for 5.3 months (the average commodity imports in 2002). This is a considerable improvement compared to the previous year, when this indicator stood at 4.

Free Movement of Goods on the Territory of Serbia and Montenegro

The Action Plan for the Harmonization of the Economic Systems of Serbia and Montenegro comprises measures designed to remove obstacles to free movement of goods, people, services and capital.
These measures foresee a considerable reduction in the existing tariff rates in Serbia, and the adoption of the new Customs Tariff Law by the end of the year. 93% of the harmonized tariff rates are coming into effect by the mid-August, while the reminder will be applied within 18 to 24 months. Among the products that will be subjected to new tariff rates in 18 months are footwear, some products of ceramic and glass, telephone sets, transmitters, etc. Meat, flour, baked products, some glass products, heating devices, vehicles, certain electric machines are some of the products that will be subjected to new tariff rates in 24 months.
Montenegro was granted the right to set up different tariff rates in accordance with its needs for 56 tariff lines of strategic products; under this regime, Montenegro is allowed to import the products in question under tariff rates currently applied in Montenegro, which are lower than the rates agreed in the Action Plan. Among these products are pork, cereals, flour, oil and sugar. The Action Plan does not foresee any other export or import quotas.
An important novelty with regard to the foreign trade regime in Serbia is the introduction of 15% export tariffs on some products of ferrous and non-ferrous metallurgy, and a 20% export tariff on raw hide. These measures are also projected to come into force as of mid-August.

Trade Balance

Although commodity exports recorded very dynamic growth in the first five months of this year, commodity imports continued to grow at a pace higher than expected, which resulted in further widening of the trade deficit. Commodity exports were nominally up by 29% year-to-year, while commodity imports increased by 33%; thus, the trade deficit rose by nearly half a million of nominal US$, being by as much as 85% higher than the total commodity exports.

A notable trend, not only in recent months, but also over the last two years, is increase in the imports of consumer goods. Namely, imports related to this group of products during the first five months of 2003 were nominally up by 50% year-to year, or by 250% compared to the same period two years ago. This growth might be in part a consequence of the expansion of credit activities of commercial banks which are less enterprises- and more population-oriented, and to the great demand for durable consumer goods. However, increase in the imports of consumer goods is primarily an indicator of the inability of domestic companies to satisfy domestic consumers with the quality, price or quantity of their products, as the population's purchasing power and probably the extent of demand sophistication improved. The inability or impossibility of the majority of Serbian enterprises in meeting the requirements of domestic demand has unsatisfactory export performances as an obvious consequence.

An enormous trade balance deficit was slightly alleviated by the positive balance on the side of current transactions (primarily owing to transfers, as well as to a mild surplus on the side of services); hence, the current account recorded a deficit of US$ 675 million in the first four months of this year.

The announced reduction of customs rates foreseen under the Action Plan, together with all other reductions in the context of negotiations on membership in the World Trade Organization and the European Union would, at least in the short run, affect growth in imports and further widening of the trade balance deficit. Some of the measures that could partially compensate the downside effects are the adoption and efficient enforcement of non-tariff measures, such as anti-dumping procedure and protection measures.

The previously advanced trends have increased the awareness of the necessity to define the national strategy for competitiveness improvement. Such a strategy would certainly have to focus on products with higher added value, which are competitive with their quality and not with price, since the structure of present trade, as well as the existing factors of competitiveness do not leave much room for any significant rise in commodity exports. Also, more attention should be paid to the development of the sector of services and its internationalization, as there is much more room for increase in foreign exchange inflow, not only in traditional services such as transport, construction and tourism, but also in business services.

However, in spite of all the measures that the Government might take in this area, any significant improvement of competitiveness is not very likely without genuine restructuring and improvement of corporate governance in the existing enterprises, as well as without dynamic growth in the number of startups and the inflow of FDIs.

Fiscal and Monetary Policy

Money supply in the first five months of 2003 was nominally up by 61% year-to-year. Deposits were growing at a higher pace (78%) than the cash money supply (36%). The level of foreign currency reserves increased by 56.9% over the same period.

The NBS's discount rate was reduced by 30.1%, while the market interest rate dropped by 39.1% over the period under consideration.

Such trends in monetary agents indicate that monetary policy is successfully achieving established objectives. The inflation rate (retail prices growth), which was only 3.7% in June 2003 relative to December 2002 proves this assessment.

Public revenues on the basis of taxes and contributions collected in the period January-June 2003 increased by 17.3%; both the collection of taxes and of social insurance contributions registered similar dynamics of growth (by 17.1% and 17.8% respectfully).

A worrisome development is that revenues on the basis of social insurance contributions were growing much slower in nominal terms than the total mass of paid wages (by about 6 percentage points). This indicates considerably lower efficiency in the collection of social insurance contributions after the restructuring of ZOP (Payment and Settlement Bureau), when this activity was transferred to the Ministry of Finance of the Republic of Serbia.

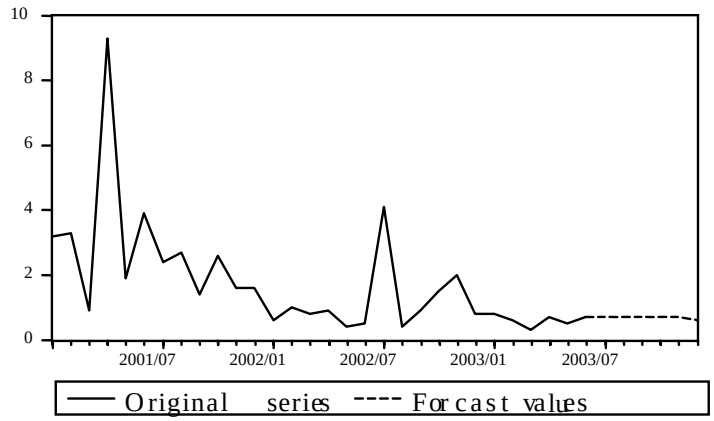
Forecasts of Macroeconomic Trends in the Second Half of 2003

In this issue of the Economic Review, we will present the results of a forecast of selected macroeconomic variables of the Serbian economy in the next six months. We added several new variables to the set of macroeconomic variables that we forecasted for the period until June 2003. In forecasting trends of the analyzed variables we applied two methodologies of time series modeling. The first methodology is based on ARIMA modeling (modeling of auto-regressive integrated processes of moving averages), while the second one is based on VAR models (modeling by vector autoregressive models). Forecasted values of the observed variables are obtained through the results of estimation of specified models. Modeling of all time series under consideration required preliminary testing to establish the degree of their integration.
For the majority of time series, the estimation of specified functional forms was carried out in the period July 1999 – May 2003. It is necessary here to point to some changes in the coverage of trends in time series which result from our wish to include dynamics in the sector of services in our analysis. Namely, the total retail trade turnover from January 2003 encompasses the value of turnover realized in private trade companies, while, as of January 2003, the value of realized construction works, realized effective working hours and the number of workers in this area has been monitored on a quarterly basis. We did not have information on trends in transport from the beginning of the year, and therefore the forecasted values of passenger and ton kilometers in passenger and freight transport refer to the whole year 2003.

Prices, Wages and Employment

Cumulative growth of retail prices, measured at 3.7% in June 2003 indicates the trend of long-term stability of these prices. Namely, according to the results of the forecast of the estimated equation, by which trends in inflation were modeled, the expected cumulative rate of retail prices in December 2003 is forecast at about 8%, while the average inflation rate in 2003 year-to-year is projected at 11.8%.

Chart 1 –Inflation Growth Rate, in %,

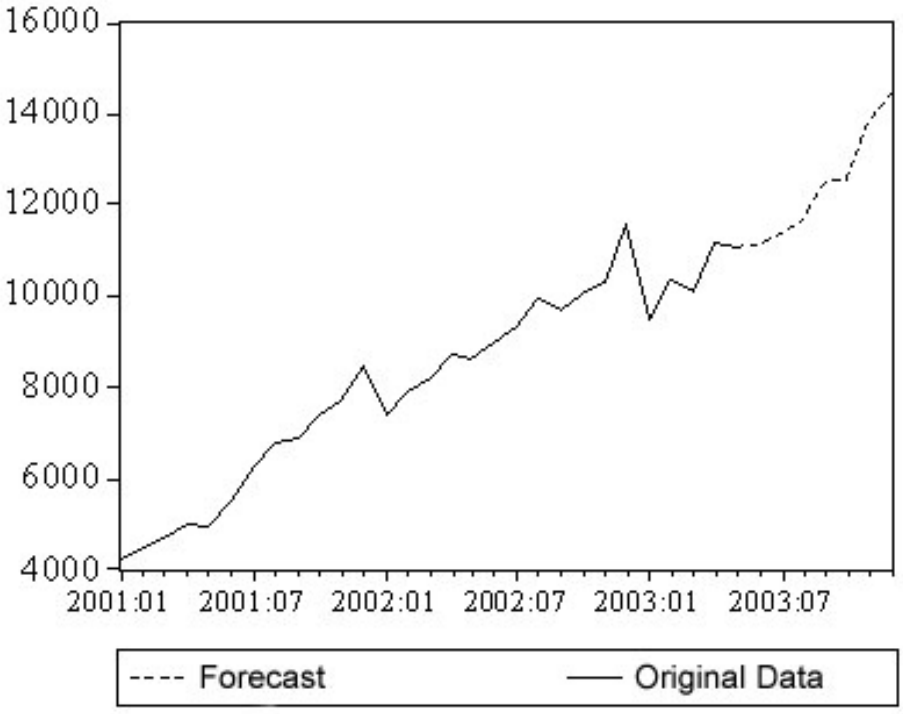


After a considerable decrease in average net wages in Serbia in January 2003 compared to December 2002, average wages have recorded a year-to-year growth in the first five months, which determines trends in this segment in the upcoming period. According to the results of the forecast of the estimated model of wages, average nominal net wages are expected to be up by 26.1% relative to the wages paid out in 2002.

We expressed average nominal net wages as a function of the inflation growth rate and the nominal exchange rate. By modeling the three observed variables, we estimated one relationship. Wages and prices are adjusted to the estimated relationship with the time lag of one period. Statistical significance of the estimated relationship is not confirmed in the equation by which trends in the nominal exchange rate were modeled. In the estimated relationship, the value of coefficients, together with growth rates in prices and the exchange rate, indicates a weaker impact of the exchange rate upon the trends in average net wages.

With regard to the projected inflation rate, wages are likely to increase by as much as 12.8%, which exceeds the projection of GDP growth in 2003.

Chart 2 – Average Nominal Net Wages, in YuD



According to current trends in the employment, the number of the employed is likely to drop by the end of the year by about 2.1%, relative to the year earlier. At the same time, total unemployment is estimated to increase by about 10.9% year-to-year. Forecasted trends in total employment and total unemployment throughout the year would result in an unemployment rate of about 33.2% in December. The forecasted unemployment rate for December 2003 would be the highest in the Serbian economy ever.

The downward trend in employment is likely to continue by the end of the year, and, together with the forecasted dynamics of industrial output, it would result in

the improvement of productivity[1] of workers in industrial production by the year-end. Productivity in 2003 is forecasted to increase by 9% compared to the productivity realized a year earlier. This would be the result of more intensive reduction of employment in the industrial sectors, compared with production trends.
Given the results of the forecast of the estimated model of average wages in the industry, they are likely to increase nominally by about 22.1%, or by 9.2% in real terms. The total number of the employed in the industry is forecasted to drop by 8.6% year-to-year.

Chart 3 – Trends in Total Employment

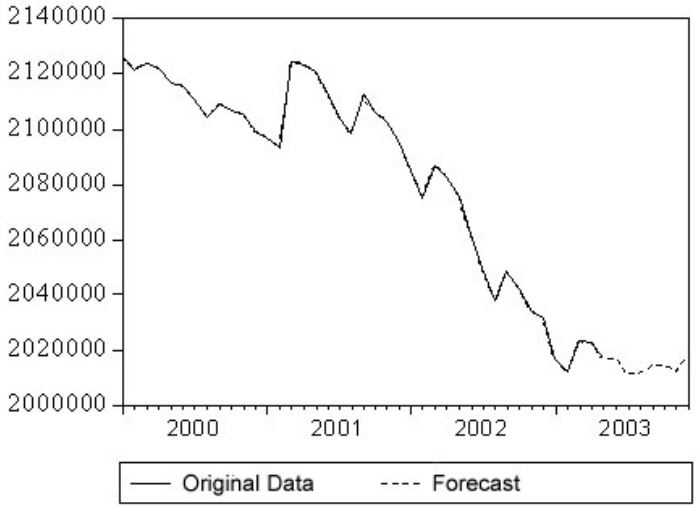
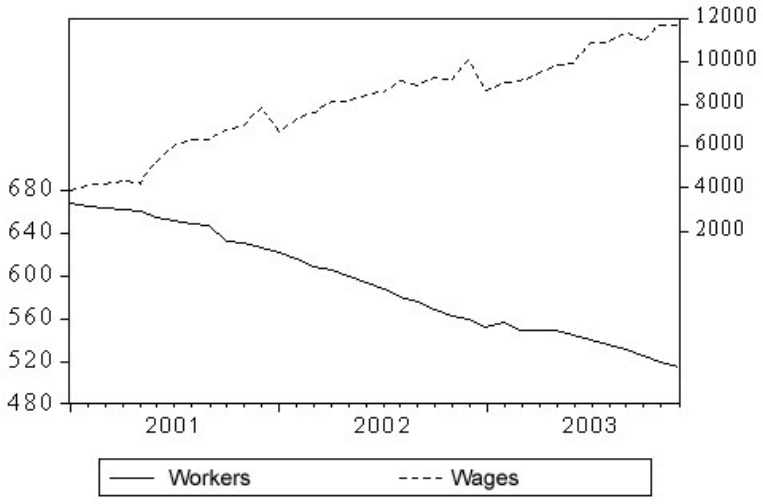


Chart 4 – Employment in the Industry (in thousands) and Average Wages of Industrial Workers

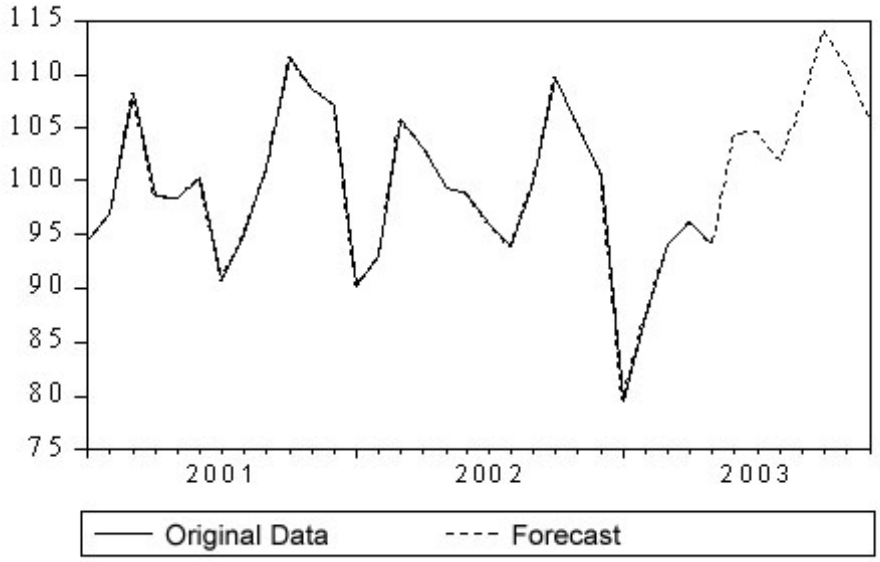


[1] Productivity of work in industry is expressed as a ratio of industrial production to the number of workers employed in this sector in the given period under consideration.

Production and Services

A sharp drop in industrial output of over 20% in January 2003 contributed to a negative cumulative growth rate in industrial production in the first six months of 2003, year-to-year. Industrial production is likely to develop at a more dynamic pace in the second half of the year. According to the forecasted values of trends in industrial production until the end of the year, industrial production is estimated to be up by 0.4%, relative to December 2002.

Chart 5– Industrial Production Index, average 1995=100



Trends in agricultural output were estimated by analyzing the value of the purchase of agricultural products by industrial producers and socially-owned estates. The total value of the purchase includes the value of purchased cereals, vegetables, fruits, stock, dairy, poultry, eggs, raw hide, wool and industrial herbs. Negative trends in the purchase of agricultural products registered last year continued in the first quarter of 2003, when the purchase value dropped by 7% year-to-year. The value of the purchase of agricultural products is, on the basis of forecasted trends in its dynamics, estimated to be lower by 3%, compared to the value of the purchases realized in the course of last year.

The value of realized construction work is a variable under the influence of seasonal factors. Having selected the appropriate models, we obtained some estimates which we further used in forecasting future trends in the value of construction works. On that basis, the value of construction works is forecast to increase by about 15% in real terms in 2003.

The realized number of tourist nights in Serbia in the first five months was lower by 3% compared to the same period last year, but with regard to final results, we estimated a year-to-year rise of 0.6% by the end of the year.

Chart 6– The Value of Purchase of Agricultural Products – in real terms, YuD thousands

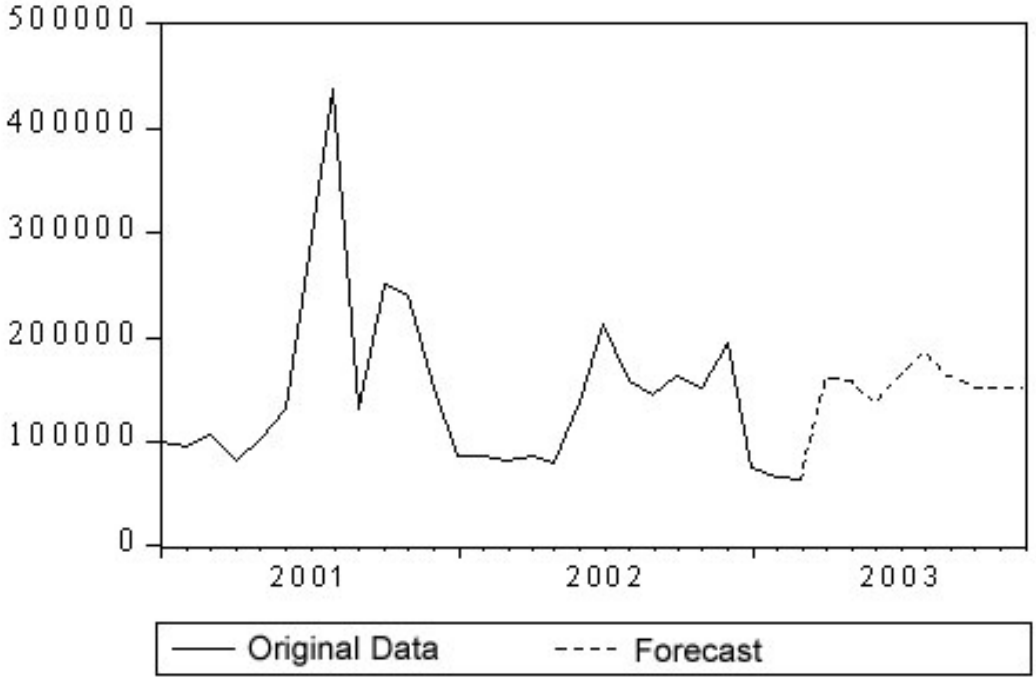
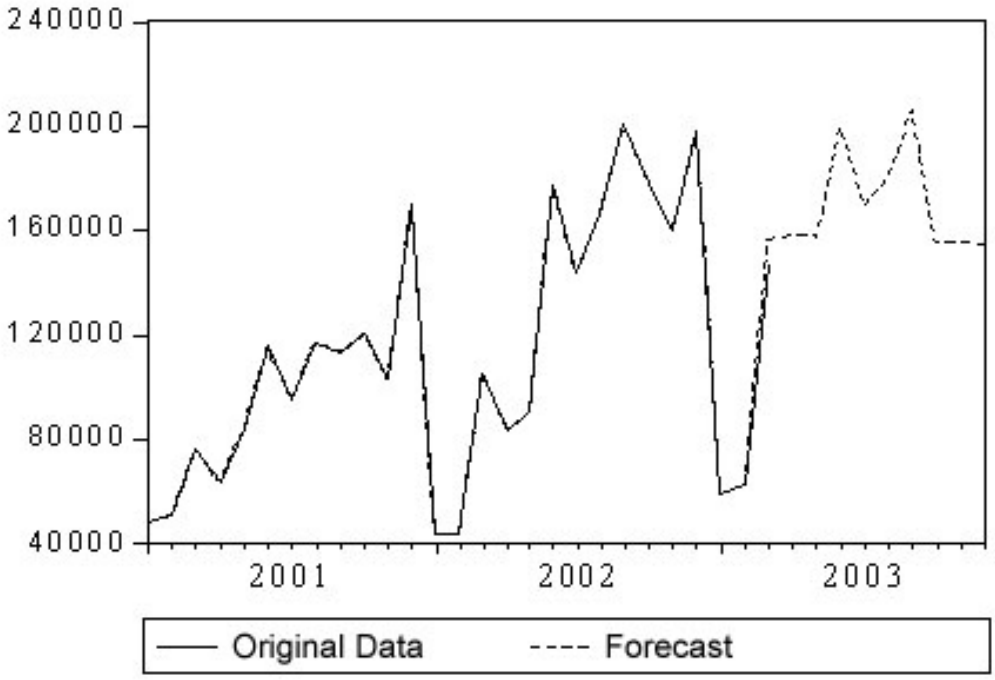


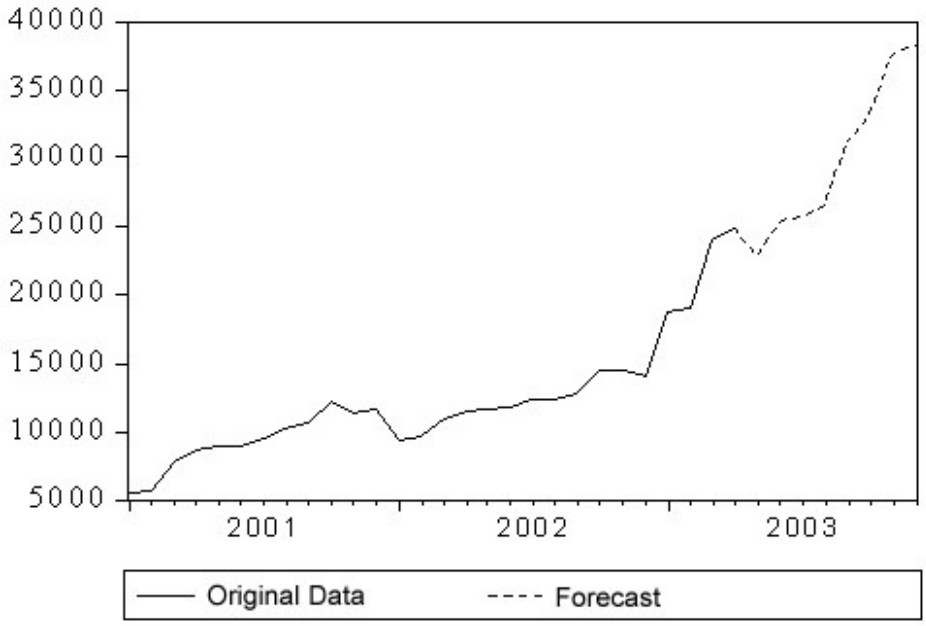
Chart 7– The Value of Realized Construction Works– in real terms, YuD thousands



As of January 2003, retail trade turnover has included the value of turnover realized in private companies operating in the trade sector, as well. Thus the structure of dynamics in retail trade turnover has changed, compared to the previous

period, because the nominal value of retail trade turnover realized in the first several months of 2003 has increased significantly.

Chart 8– Retail Trade Turnover, in YuD million

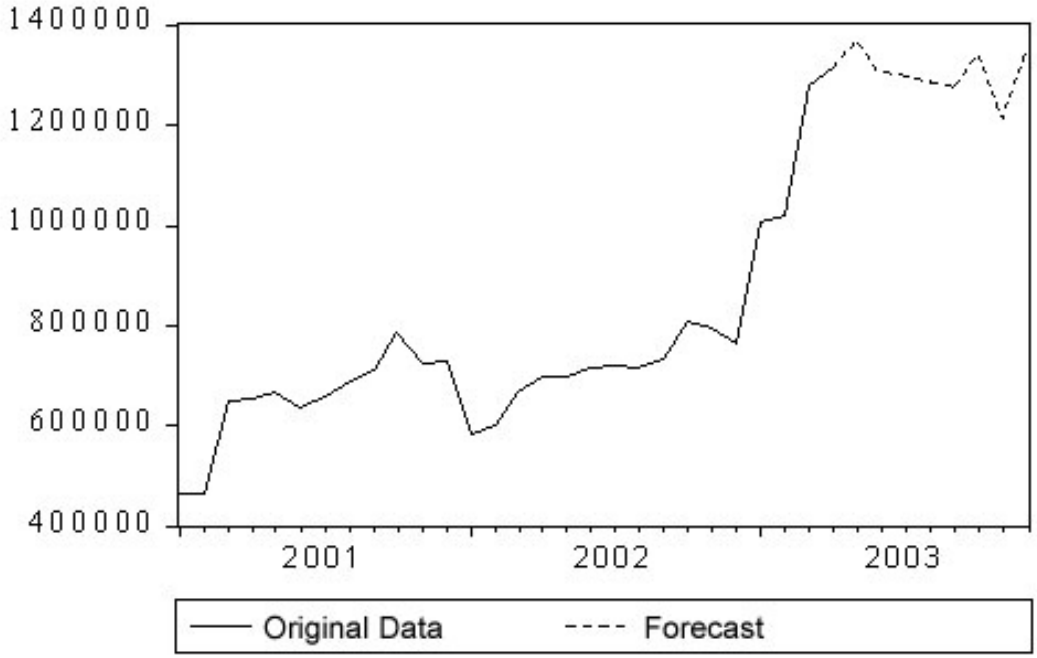


The value of retail trade turnover in real terms in the next six months is forecasted by modeling real turnover relative to trends in average real wages. The estimated model, which was used for forecasting future real turnover trends, explained over 70% of the total variability. Retail trade turnover is hence forecasted to record a cumulative growth of 33.3% in real terms in the course of 2003.

Public transport trends in 2003 were forecasted by modeling the series of the total number of kilometers realized in passenger and freight transport. Transport statistics are very poor as there is no relevant monthly monitoring of the dynamics of revenue realized in the transportation of passengers and goods according to transport branches. Much more precise estimations of the transport volume would be made if, besides the indicators of physical volume of transport, we had information on income realized on the basis of passenger and freight transport for each transport branch.

In 2002, the number of realized passenger kilometers was down by 5%, while the number of ton kilometers rose by 9%. According to the trends in the observed variables, passenger transport is forecast to increase this year. A comparison of forecasted values for this year and the values actually realized last year implies a decrease in the number of passenger kilometers by about 2%, i.e. of ton kilometers by about 4.8%.

Chart 9– Retail Trade Turnover – in real terms, YuD thousands



Foreign Trade

The set of variables by which we modeled foreign trade developments over the forecasted period comprises the following time series: commodity exports and imports, the real exchange rate[2], industrial production and industrial labor productivity. By modeling the selected set of variables, we estimated a long-run relationship formed by exports, imports and the real exchange rate. Applying the appropriate statistical procedure, we found that the real exchange rate is a weakly exogenous variable relative to the parameters of the estimated relationship. We estimated two equilibrium correction models: the model of commodity exports and the model of commodity imports. According to the results of the estimated models, besides a significant impact of the estimated relationship with the foreign exchange rate from the former period, export trends are significantly determined by trends in the productivity of work in the industry and industrial output, while as far as import trends are concerned, statistical significance lies in the dynamics of industrial production.

According to forecasted trends in commodity exports until December, the value of commodity exports is likely to increase nominally by about 29.2%, relative to the value realized in 2002. In the estimated equilibrium correction model by which commodity export trends were modeled, the set of explanatory variables explains over 74% of the total variability of exports.

Preliminary statistical data indicate that in the first five months of this year commodity imports registered a nominal growth relative to the same period last year. Due to the regularity in the trends of the import series in the former period, imports dynamics are likely to intensify. According to the results of the estimated

[2] The real exchange rate was defined as a ratio of the nominal exchange rate to the inflation growth rate in Serbia.

equilibrium correction model, the ratio of the total forecasted value of imports that is likely to be achieved this year to the real value of imports achieved in 2002, results in growth of the nominal value of imports by about 17.6%.

Chart 10– Commodity Exports, in US$ thousands

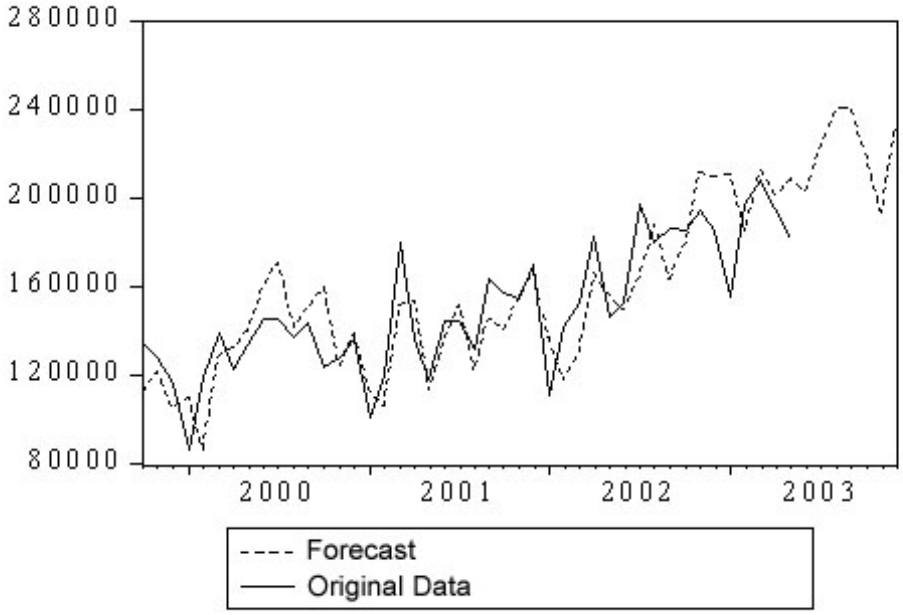
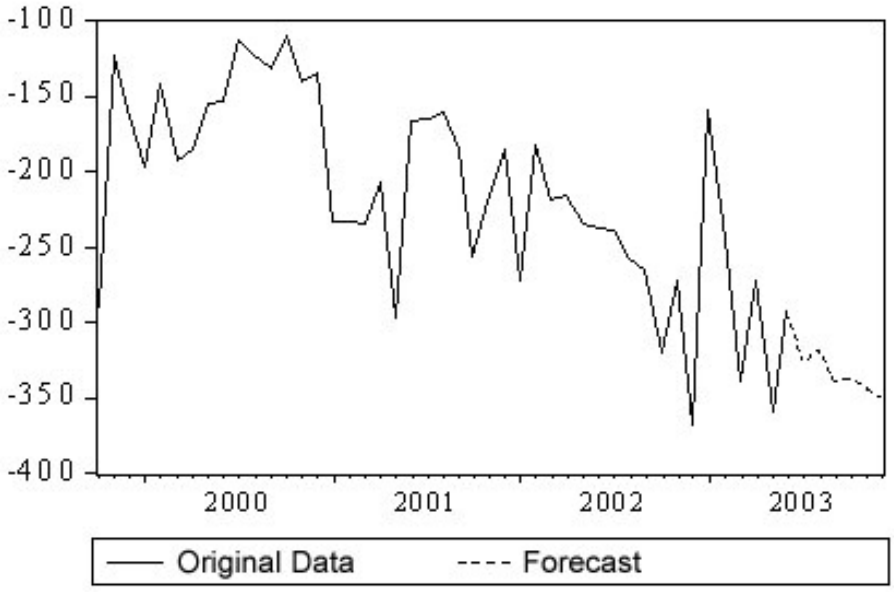


Chart 11 – Trade Balance Deficit, in US$ million



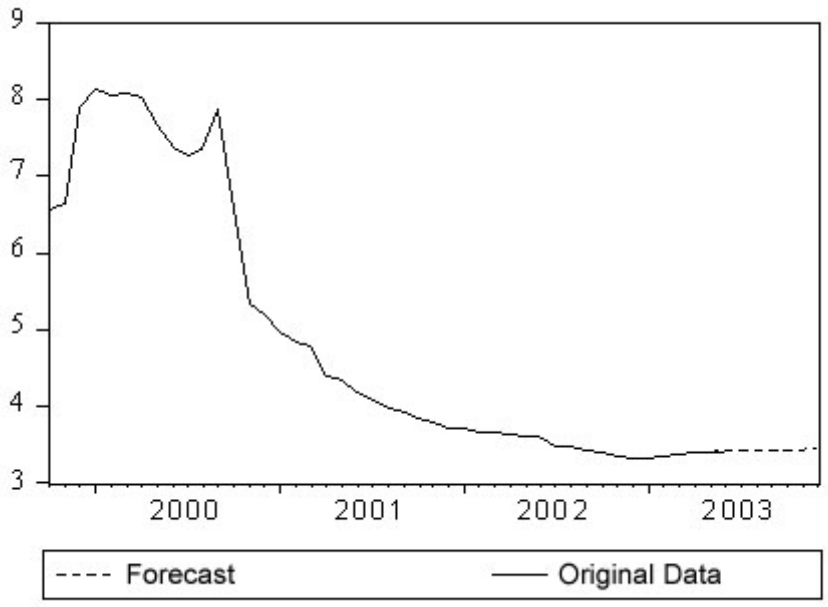
According to our forecasts, the trade balance deficit is not likely to decrease. Namely, the average monthly value of the trade balance deficit this year is estimated to be around US$ 307 million, which is up by 19.7% compared with the deficit realized in 2002.

We underline again that special attention must be paid to the interpretation of the results obtained from the forecasted trends in foreign trade by the end of the year, as they are most probably understated. Namely, statistical data on commodity exports and imports which were used in the estimation of the period June 2002 – June 2003 are only preliminary data. Additional corrections of statistical data which are made monthly will affect the obtained results of forecasts.

Exchange Rate, Money Supply and Interest Rates on Short-Term Securities

The forecasted values of the real exchange rate by the end of the year are obtained by estimating two types of models. With the first model, we expressed trends in the real exchange rate in the function of prices and the real money supply[3]. By modeling the given set of variables, we estimated their long-term relationship. Inclusion of the estimated relationship in the equation of the real exchange rate was confirmed to be statistically significant, which means that trends in the real exchange rate in the forecast period are to a significant extent explained by the previously achieved relationship with prices and real money supply. Then, by using the auto-regressive model, we modeled the real exchange rate relative to its own dynamics from the previous period. By combining obtained estimations from these two models, we forecasted trends in the real exchange rate in 2003.

Chart 12 – Real Exchange Rate

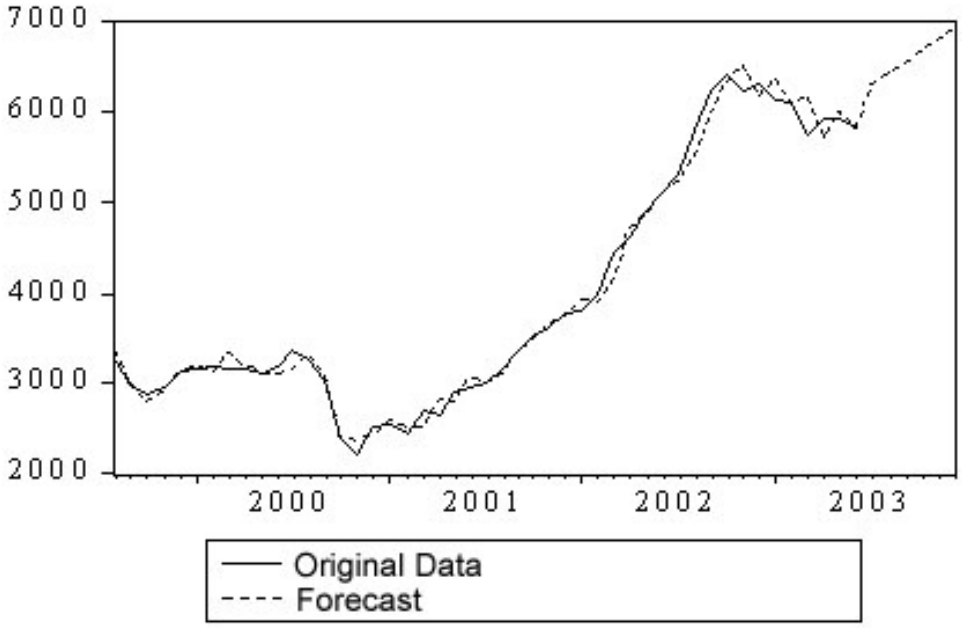


The real exchange rate is likely to depreciate in real terms on a monthly level by the end of the year. According to forecasted trends in the real exchange rate by the end of the year, real depreciation of the exchange rate by about 3.8% year-to-year is probable in December. However, if we compare forecasted trends of the exchange rate this year with the average real exchange rate realized a year

[3] Real money supply is deflationed by the inflation growth rate in Serbia

earlier, we may expect real appreciation of the exchange rate by about 3.4%. The estimated equation by which we modeled trends in the exchange rate explains the high percentage of the total variability of the real exchange rate in the forecast period.

Chart 13 – Real Money Supply, in YuD million



The real function of money demand was modeled, relative to real exchange rate and the interest rate on short-term securities. The estimation of the selected sub-set of variables formed a relationship to which trends in real money supply and interest rate conform, while the real exchange rate is identified as a weakly exogenous variable in relation to the parameters of the estimated long-term relationship. The dynamics of real money supply, estimated by the equilibrium correction model, are determined by trends in the real exchange rate and the interest rate on short-term securities, which became a statistically significant explanatory factor in real money supply trends as of the second half of 2000.

Real money supply had a declining trend in the first half of 2003. However, according to the results of the forecast of the estimated model, real money supply is likely to increase in the upcoming period. The comparison of the estimated value of real money supply in 2003 and the value realized in 2002 indicates an increase of 19.2% year-to-year.

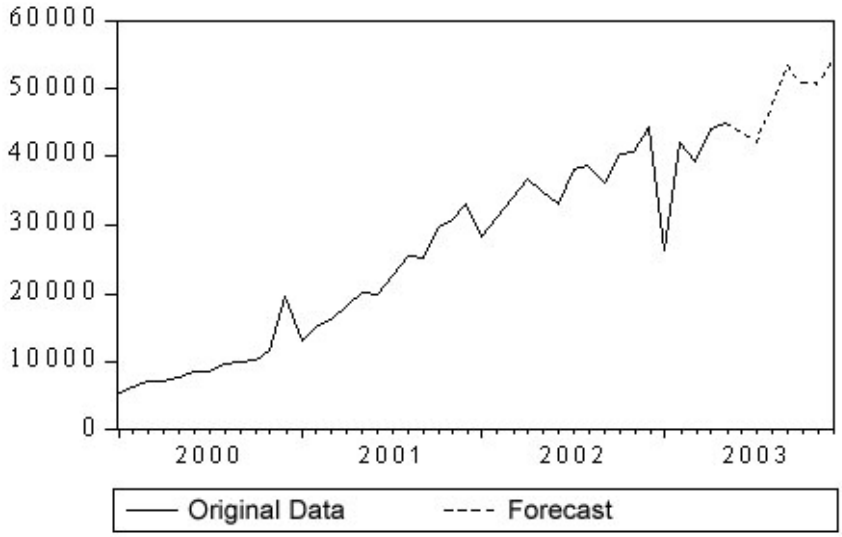
Trends in the interest rates on short-term securities were estimated by the equilibrium correction model. The results of estimations indicate that the interest rate is to a great extent determined by the real money supply and the real exchange rate.

The results of the forecasted model indicate that the interest rate on short-term securities in December is likely to be lower by about 4.3%, relative to the actual interest rate from December 2002. Interest rates are forecasted to decrease by about 23.4% in 2003, compared with the interest rate realized the year earlier.

Public Finance

Trends in total public revenues in the Serbian economy were modeled relative to trends in prices and average wages. The estimated relationship with prices and wages from the previous period, to which total public revenues are adapted, is a statistically important explanatory factor in the estimated equilibrium correction model. The estimated model covered over 72% of the dynamics of total public revenues in the analyzed period.

Chart 14 – Total Public Revenues, in YuD thousand



Public revenues are forecasted to increase by 23.3% by the end of the year, relative to the total public revenues collected in 2002.

Gross Domestic Product

Analyzing the dynamics of the most important elements on the side of production and services which are included in the structure of the gross domestic products, we forecast it to increase by over 4% in real terms in 2003. The estimated GDP growth rate is obtained by weighting the forecasted growth rates of the most important variables covered by it.
It might be said that the expected GDP growth rate in 2003 is underestimated. Namely, if the contributions of the private sector to the total volume of production and services were to a greater extent included, GDP growth this year would be very likely.

Prepared by
Iva Jovanović

COMPARATIVE ANALYSIS OF PENSION SYSTEM REFORMS IN THE COUNTRIES OF CENTRAL AND EASTERN EUROPE

On their path towards a market economy, countries of Central and Eastern Europe have faced many problems with regard to their pension systems. These problems are much more complex than those encountered in OECD countries, which mainly concern demographics, i.e. aging of the population. As far as former socialist countries are concerned, problems are for the most part the result of the past. Pension systems of each of these countries suffered serious financial difficulties. After having applied various strategies in order to adapt their pension systems to new burdens, those countries opted for reforms.
CEE countries have chosen different approaches to the restructuring of their pension systems and different rates of reforms. This makes it possible for countries in the early stages of reforms to benefit from the experience of those more advanced on the road of reforms (table 1). The experiences of Hungary and Poland are especially interesting since these countries recorded the greatest progress in the privatization of their pension systems. These two countries are currently implementing so called radical reforms which are aimed at replacing partially public pension funds with mandatory system of individual commercially managed saving accounts.
Given the commitment of our Government to the reform of pension and disability insurance, in this article we will pay special attention to two countries – Slovenia and the Czech Republic. These countries chose to reform their existing public pay-as-you-go systems. At the same time, they passed legislation which encourages citizens to save for retirement in private pension funds on voluntary basis.

1. Comparative Analysis of Pension System Reforms Implemented in the Czech Republic and in Slovenia

Policy makers in Slovenia and the Czech Republic decided not to carry out radical reforms of their pension systems for the time being. In the second half of the 90s, both countries had favorable conditions for the implementation of radical pension system reforms.
Today, pension systems in Slovenia and the Czech Republic are based on two pillars – a public mandatory PAYG system and a supplementary funded pillar. The second pillar in the Czech Republic[4] consists of a voluntary private scheme which offers individual pension plans, while in Slovenia, it involves three supplementary pension plans: a voluntary private pension insurance, either occupational or in the form of individual pension plan; mandatory insurance for occupa-

[4] According to the World Bank's terminology, this is the third pillar

tions which used to be privileged in the past, and pension funds for privatization certificates. Unlike other post-socialist countries, Slovenia and the Czech Republic did not carry out pension system reform which stimulates development of mandatory private funds to the detriment of mandatory public funds.

The context in which these two countries began reforms of their pension systems could be described as “a triple transition”, as they embarked on the consolidation of their national states alongside economic and political transformation. After ten years of transition, both Slovenia and the Czech Republic are among the most advanced post-socialist countries, and their accession to the EU is definite. Both countries have stable democratic institutions which work well, and regularly report the highest GDP per capita among the post-socialist countries – candidates for accession to the EU.

Over the last ten years, Slovenia and the Czech Republic rank first among former socialist countries with regard to human development index, calculated on the basis of UNDP methodology. Among all transition countries, these two countries report the highest life expectancy at birth (in 1999, 75.3 years in Slovenia and 74.7 years for the Czech Republic) and the highest probability at birth of surviving to age 60.

Although the share of the population aged 65 and above in the total population in these two countries in 1999 was lower than in Croatia, Estonia, Hungary and Bulgaria, they are going to surpass all other countries in the region by 2015. Both Slovenia and the Czech Republic have a low share of under-15-years-old population. Fertility is expected to fall below replacement in the coming years. Yet, decrease in the population will probably be compensated through migrations, as Slovenia and the Czech Republic currently record the highest migration rates among post-communist countries – candidates for membership in the EU.

As the old-age dependency ratio[5] largely remained unchanged in both countries in the period 1990 – 2000, it becomes obvious that the direct threat to the financial stability of pension systems in Slovenia and the Czech Republic is not posed by aging, but by transformation of the economy. Restructuring and privatization of state-owned companies affected the revenues and expenditures of public pension funds, accompanied by an increase in the number of disability pensioners and early retirements. In order to avoid larger scale unemployment, these policies resulted in an increased number of pensioners and a decreasing number of contribution payers.

[5] Ratio of population aged 65 or above to the population aged 15-64.

Country	Fundamental Reform Program			Second Pillar Introduction (mandatory funded system)			Major First Pillar Reform (PAYG system)			Third Pillar Introduction (mandatory insurance based on savings)		
	in preparation	approved	legislated	in preparation	approved	legislated	in preparation	approved	legislated	in preparation	approved	legislated
Hungary			yes			yes			yes			yes
Latvia		yes			yes				yes		yes	
Kazakhstan			yes			yes			yes			
Poland		yes				yes		yes				yes
Croatia		yes			yes			yes			yes	
Romania	yes			yes			yes			yes		
Macedonia	yes			yes			yes					
Russia	yes			yes			yes				yes	
Slovenia	yes			yes				yes		yes		
Bulgaria	yes			yes			yes				yes	
Czech Republic	yes								yes			yes
Slovakia								yes				yes
Ukraine	yes			yes			yes				yes	
Armenia	yes								yes	yes		
Georgia	yes								yes		yes	
Lithuania	yes								yes		yes	
Estonia									yes			yes
Albania									yes			yes
Kyrgyzstan	yes								yes	yes		
Uzbekistan	yes						yes			yes		
Azerbaijan	yes						yes			yes		
Moldavia	yes						yes				yes	
Byelorussia							yes					
Bosnia and Herzegovina							yes			yes		
Tajikistan							yes					

Table 1. Stage of Pension System Reforms in 25 Countries in Transition in 2001
Source: http://www.worldbank.org/transitionnewsletter/julaug98/rutkowsk.htm

Table 2 - Selected Demographic Indicators, 1999-2015

	Population under age 15 (% of total population)		Population above age 64 (% of total population)		Fertility rate (per woman)	
	1999	2015	1999	2015	1999	2015
Slovenia	16.4	11.9	13.6	18.6	2.2	1.2
Czech Republic	16.8	12.8	13.7	18.7	2.2	1.2
Eastern Europe and former Soviet Union	21.4	15.9	11.5	12.9	2.5	1.5

Source: UNDP (2001)
Note: Data for 2015 refer to medium variant projections

Table 3 - Number of Insured Persons to Pensioners, Pension Expenditures and the Replacement Rate, 1990-2000

	Number of insured persons to one pensioner		Pension expendi-tures (%GDP)	Replacement rate * (%)
	Slovenia	Czech Republic	Slovenia	
1990	2.3	-	11.7	89.2
1991	1.95	-	10.9	73.8
1992	1.7	-	13.8	78.4
1993	1.71	2	14.1	74.5
1994	1.69	2.1	14.5	77.2
1995	1.67	2.04	14.7	77.9
1996	1.65	2.07	14.7	75.8
1997	1.67	1.97	14.9	75.4
1998	1.66	1.93	14.3	75.6
1999	1.68	1.84	14.4	76.8
2000	1.67	1.8	14.6	76.1

*Replacement rate is the average net old-age pension divided by the average wage. “Net” is equal to “gross” minus social security contributions and personal income tax.
Sources: Institute for Pension and Disability Insurance, annual reports of the social protection system in Slovenia, White Paper on pension reform; Bulletin of the Bank of Slovenia; and ILO, *Pension Reform in Central and Eastern Europe* (2002)
Pension expenditures rose both in Slovenia and the Czech Republic in the last ten years. It was therefore necessary to increase transfers from the state budget in order to cover pension expenditures.
It is difficult to make comparisons due to some shortcomings in the data for the Czech Republic for the period until 1993. Slovenia recorded the highest increase in pension expenditures in the early 1990s, when the country faced a significant drop in the number of insured persons relative to pensioners. Unlike in Slovenia,

in the Czech Republic this problem was not significant until the late 90s, when the economic crisis lead to growth in the unemployment rate.
Slovenia faced stronger pressure to reform its pension system because the net replacement rate reached 89.2% of the wage in 1999, while it remained very high in 2000 as well, i.e. 76.1%. In the Czech Republic, the net replacement rate amounted to 65.2% and 57.2% of the wage respectively. Slovenia had more fiscal space than the Czech Republic and that is why this country could afford greater fiscal transfers to the pension system.
When economic and political transformation started, it became clear both in Slovenia and in the Czech Republic that the systems of pension insurance inherited from socialism needed reform in order to ensure their financial stability and to adapt some features of the pension systems from the past regime to the new economic order. The reforms they were preparing mainly referred to the reform of the public PAYG system (table 4), gradual increase of the retirement age, introduction of stricter retirement conditions, more restrictive conditions for early retirement and disability pensions, abolition of special benefits for certain occupations in the Czech Republic and their transformation into the regime which are capitalized and funded by employers.

Table 4 – Basic Features of the Public Pension Schemes in the Czech Republic and Slovenia

Characteristics	Czech Republic	Slovenia
Type	mandatory, PAYG	mandatory, PAYG
Nominal contribution rate	26.0	24.35
- employee	6.5	15.50
- employer	19.5	8.85
Contribution ceiling	none	none
Separation of pension fund from state budget	None, but specially earmarked account exists	Yes, autonomous pension insurance institute
Structure of pension formula	Flat-rate basic part + earnings-related component	Benefit calculation based on individual wage history and contributory years
Minimum insurance period	25	15
Earnings considered in pension base	Last 30 years (2016.god.)	Average of best 18 years
Pensionable age after transition period (men/women)	62/57-61	65/63*
Bonus for late retirement	Yes	Yes
Penalties for early retirement	Yes	Yes, if prior to age 61/63 (with many exceptions)
Branch privileges	Abolished	Transformed into separate contributory funded tier

Source: Mácha i Stanovnik, ILO, Pension Reform in Central and Eastern Europe (2002); Müller (1999)
*For a pension qualifying period of 20 years and above the full Pensionable age is 63/61 (men/women).

2. Reforms of the Pay-As-You-Go Pension Systems

2.1. Reform of the "First Pillar" In Slovenia

There were two major legislative attempts to improve the position of the PAYG system in Slovenia – Pension and Disability Insurance Laws from 1992 and 1999. The 1992 Law mainly tightened retirement conditions as a reaction to the growing expenditures for pensions, while the 1999 Law introduced the system of penalties and bonuses for early and postponed retirement, increased the retirement age for women, reduced accrual rates of the pension base in pension calculation formulas for each additional year of work and further tightened pension conditions.
The 1999 Law made the system rather complex, partly because of protracted negotiations within the governing coalition, and even more because of negotiations between the government and social partners.

The most important element in the calculation of the pension base is the pension qualifying period which includes years of service, as well as any purchased period or special qualifying period (refers to additional years credited by the state on the basis of, for example, time spent in World War II). There is also an added qualifying period, relevant only for achieving pension conditions, but not for the calculation of the pension, e.g. years of university education, military service, etc. These years can also be purchased, and in that case they become the pension qualifying period, i.e. purchased period.
The 1999 Law introduced a few elements that improved horizontal gender equality. Gender differences with regard to retirement conditions and benefits were considerably reduced (Table 4). Among other things, much more attention was paid to actuarial fairness, following the introduction of "maluses", i.e. penalties for early retirement and bonuses for later retirement relative to full pensionable age (63 for men and 61 for women). The period for the calculation of the pension base was extended to the best eighteen years, compared to the previous best ten years of service.
Even greater emphasis was laid on vertical equity, or "inter-generation solidarity". The ratio between two comparable pensions[6] cannot exceed 4:1, which is considerably narrower than the previous 4.8:1.
The main novelty in the first pillar, introduced under the 1999 Law, is flexible retirement, with the system of maluses and bonuses, which is similar to the Italian system. The retirement criteria became stricter, especially for women, and the

[6] Comparable pensions exist for persons who enter the pension system under the same conditions, both of them having a full pension qualifying period of 40 years for men and 38 years for women.

benefit level was significantly reduced. If a person is not subject to maluses, his/her pension will amount to 72.5% of the pension base after 40 years of work. If the best eighteen-year period is taken as a basis for pension calculation, the reduction in pensions is even greater. However, new regulations for retirement and pension calculation have been introduced gradually.

2.2. Reform of the "First Pillar" In the Czech Republic

The main parametric reform which has been in force as of 1996 retained some former elements, such as a unified system for all economically active persons, the vesting period of 25 years and a different retirement age for women according to the number of children raised. Plenty of new elements and principles were introduced, as well. The most important ones refer to the introduction of a two-tier structure for pensions and an increased retirement age. All pensions now consist of a basic flat-rate sum and an earnings-related element. The basic amount is fixed, being paid out only once, even if the beneficiary draws two or more pensions. The earnings-related part is calculated on the basis of the average wage earned during the last ten years of work prior to retirement. This period is being extended every year by one year. It stands at 15 years at present, and will be increased until it reaches 30 by 2016.
Among the most important changes was the increase in the retirement age from age 60 to 62 for men, and from age 53-57 to 57-61 for women. This increase was followed by very generous conditions for early retirement. The number of persons who opted for early retirement considerably grew in the period 1997-2000, in part owing to the generosity of benefits and in part due to the significant rise in unemployment. Under pressure, which resulted from financial imbalance of the system, the government introduced stricter conditions for early retirement in 2001. Although reduction rates for early retirement were increased in 2001, they are still bellow actuarially fair rates.
The 1995 Law also introduced a set of clear rules for benefits adjustment. Although it increased the real value of pensions and the pension/wage ratio, pensions are still well below the 1989 levels.

3. Supplementary Insurance Models

3.1. Voluntary Supplementary Insurance in the Czech Republic

Besides parametric reforms which are aimed at improving financial viability of the public PAYG systems, policy makers in many transition countries decided to introduce supplementary insurance models on a voluntary basis in order to encourage self reliance in ensuring security for old age. Moreover, new pension funds were expected to provide long-term investment capital, thus contributing to the development of local capital markets. This model was followed in the Czech Republic, and under the 1994 law on pension insurance, this country allowed setting up supplementary private pension funds. The proposal to establish occupa-

tional pension funds was not accepted. Although the number of private pension funds flourished, reaching the figure of 44 in 1995-96, the amount of voluntary contributions collected fell short of initial expectations. In 2000, with 43% of the labor force participating in supplementary insurance in the remaining 19 funds, total assets reached merely 2.3% of the GDP. For the most part this was due to the fact that, on average, beneficiaries spent only about 3% of their average wages for monthly contributions. After amendments from January 2000, more favorable tax incentives were introduced. The effect of this measure on the collected capital and participation in funds remains yet to be seen.

Table 5 – Development of Supplementary Pension Insurance in the Czech Republic 1994-2000

Indicator	1994	1995	1996	1997	1998	1999	2000
Number of participants (in thousands)	183	1,290	1,546	1,637	1,740	2,006	2,281
Number of participants (as % of economically active population)	3.7	25.7	30.7	33.1	35.7	42.7	49.7
Total assets (in CZK bn)	0.1	4.4	11.5	19.6	28.4	37.7	43.2
Total assets (as % of GDP)	0.0	0.3	0.7	1.2	1.6	2.1	2.3
Operating costs (as % of total assets)		9.0	3.3	4.2	3.9	2.5	2.5
Average monthly contribution (amount of state contributions)	118 (43)	262 (93)	305 (103)	333 (97)	329 (93)	39 (96)	351 (97)
Average monthly contribution (as % of average wage)	1.7	3.2	3.2	3.1	2.8	2.7	2.6
Number of pension funds		44	44	38	29	22	19

Source: Ministry of Labor and Social Affairs

Many shortcomings were detected in the area of supplementary insurance throughout the first five years of operation, the most important of them being the following: operating costs of pension funds were very high and not separated from assets; the level of state contributions were not adjusted to reflect changes in wages and prices, which resulted in a fall in interest in supplementary insurance; average contributions paid by participants were rather low and therefore pension funds income stagnated; supplementary insurance was originally planned to serve as a form of long-term savings scheme for younger age groups, but was instead used by the elderly as a form of short-term savings scheme; authority and powers of supervisory institutions were inadequate. Consequently, the Law on Supplementary Pension Insurance was amended in 2000; these amendments increased the authority of the state's supervision of pension funds and obliged pension funds to raise their minimum capital. The main reason for these changes was to prevent bankruptcy of pension funds. To discourage this insurance to be used as short-term investments, the minimum savings period was increased to five years, whereas savings could only be withdrawn when participant reaches the age of 60.

Table 6 - Basic Features of the Voluntary Supplementary Funds in the Czech Republic and Slovenia *

Characteristics	*Czech Republic*	*Slovenia*
Year of introduction	1994	2000
Financing	fully-funded	fully-funded
Types of pension plans offered	personal	personal or occupational
Corporate structure	joint stock companies	joint stock companies or mutual funds
Government incentives	state subsidy and tax incentives	tax incentives
Employer's contributions	tax-exempt (with ceiling)	tax-exempt (with ceiling)
Supervision	Ministry of Finance	Insurance Supervision Agency or Securities Market Agency
Number of funds	18	15
Number of members (in thousands)	2,281	40
Members as % of population	22.3	0.02
Total assets (% of GDP)	2.3	-

Source: Mácha i Stanovnik, ILO, Pension Reform in Central and Eastern Europe (2002); Müller (1999)

*Here only the competitive supplementary schemes are covered, i.e. both the state-owned "First Pension Fund" and the monolithic supplementary scheme introduced in 1992 are left out of consideration.

3.1. Introduction of Supplementary Pension Scheme in Slovenia

Slovenia had a much more heterogeneous approach to supplementary pension insurance. Supplementary pension insurance in Slovenia was introduced in 1992. Having been run by a public monopoly, it could not manage to attract more than a couple of hundred participants due to the absence of tax incentives[7]. At the end of 1999 the market was finally opened to private providers of collective and individual insurance schemes, resulting in a coexistence of occupational schemes which are sponsored by employer and individual personal pension arrangements. Slovenia introduced mandatory supplementary insurance which covers beneficiaries involved in particularly hard and health damaging work, or ones performing activities which cannot be continued after attaining a certain age. For these occupations employers are obliged to pay higher contributions. The amount above the normal contribution rate defined under the Law is capitalized at "Kapitalska druzba", making it possible for this special category of beneficiaries to opt for early retirement from supplementary scheme. The other new insurance is run by the "First pension Fund", which is also managed by "Kapitalska

[7] At the end of 2000 there were only 739 individual contracts.

druzba". This is a voluntary insurance which allows the citizens of Slovenia to exchange their remaining ownership certificates from privatization for pension coupons. At present, only 5% of the total value of the remaining ownership certificates has been allotted to the First Pension Fund.
Tax incentives for collective schemes are rather favorable and depend on a threshold in terms of the number of employees participating in the scheme. The threshold was initially set at 66% of the workforce of a given employer, but under amendments from January 2002, that threshold was reduced to 51%.
The number of pension funds and companies grew rapidly. Coverage of the labor force by insurance depends to a great extent on whether those employed in the public sector will join the supplementary pension schemes. The number of companies and funds which offer pension insurance seems likely to drop following their consolidation.

4. Reasons Why Privatization of the Pension System Did Not Occur in the Czech Republic and Slovenia

Full or partial privatization of the pension system is feasible when the actors inclined to pension reform, i.e. the Ministry of Finance and the World Bank, participate in the reform process. For example, radical pension reforms have not continued in those countries where the Ministry of Labor and Social Issues existed as the only relevant actors of pension reform.
A fiscal crisis turns the Ministry of Finance into a potential participant in pension reform, especially when financing of pension insurance records deficits and consequently becomes dependant on state subsidies.
Another factor is also of importance - namely, under conditions of high foreign debt, governments are prone to stress their general commitment toward market-oriented reforms. In that context, the announcement of privatization of the pension system might be interpreted as a signal. And really, by the mid-90s, agencies which rank and assess countries were including radical pension reform as a point in favor of assessing the level of risk in the country in question. Critical indebtedness also increases the likelihood that international financial institutions will take part in local pension reforms. Policy makers were well aware that financial and/or technical assistance by international financial organizations was reserved only for those pension reforms which involved privatization.
Although full or partial privatization of pension insurance was clearly the major recommendation by external factors to all East European countries facing pension system reforms, ultimately, domestic political decisions resulted in acceptance or rejection of radical pension reform.
The amount of implied debt[8] gives a picture of long-term (in)stability of a pension system. Implied pension debt is determined by many factors, in particular by the degree of coverage of a population, the maturity of the system and abundance of

[8] Current value of promised pensions owed to present pensioners and workers on the basis of their contributions in the old system.

benefits. When it becomes explicit, it turns into a huge fiscal expenditure. Therefore, the greater the implied pension debt, the smaller the probability for the most radical structural pension reform.

4.1. Slovenia

The reform implemented in Slovenia does not represent fundamental or radical change in the area of social policy. Although the option of introducing a mandatory funded second pillar was taken into consideration very seriously during the process of reforms, especially since the World Bank's experts[9] insisted on it, the proposal was rejected after the government's reform proposals were made public. In early 1998, one of the most influential economists in Slovenia, Vladimir Bole, assessed in his study that the total fiscal deficit as a result of the transition to a three-tier system (assuming that 8% of the contribution rate goes to the second pillar) would reach the level of 75% of GDP in 2030 and 102% of GDP un 2050. Under the second scenario described by this author, which postulates a pension system consisting of the first and the third pillars only, the accumulated fiscal deficit would be much lower, amounting to 16% of GDP by 2030 and 25% of GDP by 2050. Thus, Mr. Bole was not in favor of the introduction of the second pillar. On that basis, Slovenian trade unions put a veto on pension system privatization in 1998 and on the introduction of the mandatory second pillar. Therefore, in the middle of 1998, the Slovenian government decided to begin the reform of the public PAYG scheme in combination with the introduction of a voluntarily funded tier. After long negotiations within governing coalition and among social partners, this Law was passed in December 1999. The decision-making process in Slovenia, with the rather wide political coalition that was in power in the period 1997-2000 was more a search for consensus than a rapid implementation of radical structural reforms. Hence, strong opposition by unions and the lack of support on the part of the Ministry of Finance contributed to the rejection of a proposal to introduce the second pillar. Also, owing to a good fiscal position of Slovenia, the World Bank was not in a position to play any major role in the process of pension reforms. Thus, circumstances were not in favor of the establishment of the second pillar.

Public opinion polling was regularly conducted during the pension reform process, and particularly during the final phase of negotiations among social partners, from October 1998 through April 1999. According to these polls, a large portion of respondents (about 70%) was in favor of reform, but only 10% said they fully understood its basic features. Public support weakened over time, probably as people became more informed and aware of consequences. While in November 1998, 54% of respondents supported reform proposals, this support recorded a constant drop, which shrank to as little as 45% in March 1999.

[9] The IMF and World Bank's experts calculated the implied debt of the pension system in Slovenia to be very high, between 2 and 2.6 of the annual GDP. In comparison to G-7 countries, only Italy records a higher implied debt. The World Bank recommended a combined approach with three pillars, with a mandatory and fully funded second pillar.

However, reform yielded significant changes, although the approach was gradual. Parametric changes within the public pension system significantly tightened retirement conditions and benefit levels, at the same time as increasing the redistributive function relative to the insurance function. It is still early to anticipate to what extent decrease in the pension/wage ratio within the first pillar will be compensated by supplementary benefits from the second pillar.
The success of the pension reform in Slovenia is highly dependant on successful expansion of voluntary supplementary pension schemes. This, on the other hand, depends on whether future collective bargaining on wages will include employers' contributions to the second pillar. If the agreement between employers and workers is realized and voluntary scheme coverage grows rapidly, pension reform could achieve the unachievable – i.e. fiscal viability together with satisfactory pensions for the elderly.

4.2. The Czech Republic

Pension system reform in the Czech Republic began during a period of relatively stable economic conditions, low unemployment and absence of social conflicts. These conditions were ideal for implementing experts-lead reforms. By the mid-90s, major conflicts with regard to pension reform in the Czech Republic concerned the extent of parametric reforms. After the simulation of total impact and costs linked to partial privatization of the Czech pension insurance, and of alternative solutions for implementing a thorough reform of the existing PAYG system, experts at the Labor Ministry concluded that there was still enough room within the existing public PAYG system to face the challenges in the decades to come. The concept of reform adopted by the Czech government in 2001 relies on the continued existence of the pension system based on two pillars, i.e. mandatory pension insurance (funded from current inflow of contributions) and voluntary supplementary insurance (fully capitalized).
The Czech Government kept refusing privatization of pension insurance (old age) primarily because of the high costs of transition to such as system. Transitional costs that would result from partial privatization of the pension system, assuming the introduction of new and fully capitalized insurance alongside the existing PAYG system, were assessed as very high. Such a privatization would entail that the new pillar is mandatory only for new participants at the labor market, i.e. people under the age of 20. Transitional costs were calculated in the form of additional percentage points that should be added to current pension contributions. Bearing in mind the still unstable foundations of the local capital market, the introduction of a mandatory capitalized tier is considered to be especially inappropriate.
Because of low foreign debt, the World Bank did not have considerable influence on pension system reform in the Czech Republic.
Another factor that influenced such a decision is political. Namely, there were three stages of reform in the Czech Republic, each one having included different political actors and several stakeholders set against each other. In 1996, a very

important year when Poland and Hungary started preparing for partial privatization of their pension systems, the Czech government did not have a majority in parliament. Also, the Czech Prime Minister Vaclav Klaus has never been too much in favor of the idea of a mandatory capitalized pillar; he was more in favor of lower compensation rates in the public pillar in order to stimulate Czechs to voluntary take part in supplementary insurance.

It is clear that the final decision on pension system reform is in the hands of politicians, although other stakeholders have a certain influence, as well. A compromise that will result in extensive parametric reform will be the most likely scenario in the future. It will probably involve the promotion of the NDC model and further incentives to the development of voluntary supplementary models.

Dušan Pavlović

PRIVATIZATION POLICY IN SERBIA IN 2003

(Policy Recommendations)

Two years after the privatization law has come into force and the process was launched, privatization in Serbia has yet to yield anticipated results. Private property is still not prevalent; there is little evidence of substantial restructuring in corporate governance or of improved performance in privatized companies; and growth is still not picking up. By mid-June, 2003, 20 large firms have been sold (out of 200), and 545 smaller ones (out of 7,000). The revenue totals some $525 million USD ($229 in tenders, $195 in auctions, and $101 in the stock market exchange).

The complex reality of privatization mandates clean sales, competent and honest owners, and quick privatization. Unfortunately, all this cannot be accomplished at the same time, and some aspects of privatization have to be sacrificed. If one goal has to be traded off for another, experience teaches us that it is better to sacrifice some speed for improved quality. Effectiveness and legitimacy rather than speed of the process are in this paper taken to be essential for a successful privatization at this point. The paper sets out nine recommendations for a privatization policy that could make the privatization process more effective and legitimate.

1. The privatization policy model should not be changed or amended by other models that do not involve direct sale.

- The existing privatization policy is based on the model of direct sale according to which up to 70% of the shares of a firm are sold either in tender or in public auction. This model has proven to yield best results in countries in transition in the last decade. It generates revenues for the government that can be used up for servicing foreign debt, reducing budget deficits, and building public sector institutions that will stimulate better corporate governance.

- The standard objection—that the direct sale model is flawed because “it cannot work without full-blown market institutions (wide openness of the market, developed financial market, and high level of competition), which still do not exist in Serbia”—is itself flawed. In Hungary and Estonia, where the model was applied, market institutions were weak and fragile in the beginning of the 90s. Yet these two countries are regarded today as successful privatization cases. In addition, more than 385 auctions carried out so far in Serbia have exhibited no grave market failures. Third, although it is true that the tender procedure is administered by the government (which diminishes the impact of market competition), that is simply the nature of

the tender procedure, regardless of the environment in which it takes place. (Other problems related to the tender procedure are addressed in sections 2 and 8.)

- The argument that the market is necessary in order to carry out the direct sale privatization model points at the misunderstanding of the goals of a privatization policy within the context of economic transformation. Privatization is meant to create market institutions. If Serbia was already a market economy, a comprehensive privatization program would not be required.

2. The agency of privatization should settle on the price as the key criterion by which it sells big enterprises in tender.

- The Serbian government established four criteria that are decisive for tender sale of an enterprise: price, social program, future investments, and environmental program. The number of criteria brings about a number of problems. First, the method makes the comparison of the bids complicated, if not impossible. Second, the agency of privatization enjoys a discretionary right to decide which criterion is decisive for each particular sale. This discretionary right does not contribute to the transparency of the privatization process; it rather gives rise to the suspicion that corruption is possible. Selecting one single criterion by which the enterprises are sold beats off the objection that the process is non-transparent and corrupt.

- The price of the firm, not future investment or any other criterion should be the key criterion for sale. It goes against the logic of private property to oblige the bidder to invest in his own property. Additional social and environmental conditions essentially lower the price of the firm. Beside the fact that the conditions may never be fulfilled, they can potentially make a mockery of the sale. (In October 2002, to take one such example, three large sugar factories were sold for €3 each.) By insisting on more than one criterion, the government shows it wants to pursue manifold goals with one policy. The goal of the privatization policy is to sell enterprises. Other public policy goals are legitimate but they are best pursued by other policies (e.g. taxation, accounting legislation, environmental protection laws, etc.).

- To achieve this, it is not necessary to eliminate from the sale procedure all conditions that are not related to the price. It suffices to adopt minimal requirements that determine social program and future level of foreign investments that must be met by every bidder, and let the price affect the decision as to whom to sell the enterprise. (How such a sale could look like see in section 8.)

3. The pace of selling firms in tenders and in auctions, considering the circumstances, could speed up.

- Excessively hasty pacing and sequencing may create social problems that could have adverse effects on privatization and the reforms. Successful privatization increases growth in the medium-term but always brings about job losses in the short-term. The government should take steps to ensure that workers, who unavoidably lose jobs, have a chance to find new jobs. This can be done by retraining programs, but much more effectively by higher levels of FDIs (see section 4).

- The agency of privatization could step up privatization of smaller firms, considering the fact that some 10% of the total number was privatized in this way. In many countries in transition small firms have been major investment and employment generators. However, it is quite possible that, considering the circumstances (shortage of investment capital in Serbia) and the capacity of the agency, the pace of auction sales has reached its peak. (How auction sales can be accelerated is discussed in section 6). Privatization of bigger firms should accelerate gradually in accordance with the opening of new jobs.

- One should not fear that faster privatization will exacerbate the situation on the labor market. Nowhere in East Central Europe has privatization led to social disaster. The unemployment rate in the Czech Republic in 1991 was 4.1%, and in 1998, 7.5%. In Hungary, in the same years, it was 7.4% and 7.8%, respectively. In 2000, Serbia had 12.6% and in 2002, the unemployment rate was 13.8%. The reason why larger social unrest did not occur was that the government did not act entirely in agreement with market principles in privatizing socially-owned firms. As long as this is the case with the Serbian privatization program, privatization can move faster.

4. The government must intensify its efforts to remove obstacles for direct investments.

- Privatization is not a panacea for a transitional economy. It sets the precondition for growth, but also implies layoffs, other forms of restructuring, and time-consuming changes in the way the economy functions. Privatization must be a part of a comprehensive program, the most important part of which is the attraction of FDI that builds new, competitive firms, and creates new jobs. FDI does not come into an environment in which there are too many obstacles. In Serbia, the obstacles are mainly of an administrative nature. The average time for registering a firm in the beginning of 2002 amounted to 50 days and cost €230 on average. Comparable costs are expected in terms of real estate, operating licenses, equipment, imports and transit of goods, commodity exports, certification of products

and services, inspections etc. Such an environment is FDI-diverting, rather than FDI-attracting.

- On the other hand, the corporate tax rate also does not seem to be investment-attracting enough. Although Serbia has one of the lowest corporate tax rates in the region (14%), it still appears to be too high to attract the sought-for level of FDI. In 2002, FDI was mostly concentrated in trade, and not in production, which is why trade growth rate was 8.5%, whereas the industrial production growth rate was only 1.7%. In many countries—not only in those that employed the same method in privatizing—the government gave tax holidays for greenfield investment in the beginning of the transition. The same could be tried in Serbia.

- The removal of the administrative barriers is critical for starting up small and medium sized Serbian companies. The most important reason for the low level of investments for bigger foreign companies is most likely bound up with the weak rule of law, macroeconomic imbalances and high risks (including political risks).

5. The government should accelerate the building of other necessary market institutions (notably, the bankruptcy law and investment funds).

- Serbia still does not have a complete bankruptcy law but only an insolvency law. This model of privatization dominated the Polish privatization program, Until March 1992, over 1,000 socially-owned firms went bankrupt, which enabled the creation of 545 new firms. The absence of the bankruptcy law enables firms to default on loans and get liquidated without the lender being compensated. The repercussions are dangerous:
    - Banks will not lend if they are not sure they can protect their assets; the shortage of investment and working capital does not contribute to the increase of growth;
    - The government will be under pressure to bail out companies when they default on loans, which imposes financial burden on the state budget;
    - The number of inefficient enterprises will not decrease, which causes their “healthy” assets to lie dormant.

- The investment funds law allows for the protection of smaller holders. There are lots of small stockholders who became stockholders under the 1997 privatization law. Besides, since the privatization program implies a free distribution of up to 30% of shares to insiders, there will be lots of small stockholders who will be created under the 2001 law. The example of the Apatin brewery shows how these smaller stockholders are unprotected, which undermines the belief of small holders that privatization pays

off. Financial market institutions are necessary, for it is significant to enable small holders to trade their shares safely.

- The land registry is also one of the greatest problems in implementing the privatization program. It turned out that there are cases in which it is not possible to sell an enterprise because its company information is not entered in the land registry. The registry is a data base that serves as a basis for settling legal disputes between conflicting parties. For the solution of this problem, it is of paramount importance to amend the registry legislation.

6. The agency of privatization has monopolized the privatization process. Its sway should be lessened, especially when it comes to the kickoff for the process.

- The agency is in charge of "promoting, initiating, carrying out, and controlling the privatization process." Although the privatization law (art. 16) postulates that privatization of a firm can be initiated by the firm itself, the ministry of privatization and the potential investor, in practice the agency appears to be the dominant agent in these matters.

- The agency cannot control itself. This should be done by the Council for fight against corruption, or some other special body established especially for this purpose.

- The privatization law should be amended to allow greater freedom to investors and firms to kick off privatization without the permission of the agency. The agency could retain the right to block the process if there is a reasonable doubt that crooks and drug-dealers intend to "privatize" a firm, but there should be some way for investors to initiate privatization.

- Article 61 of the privatization law by which local authorities get 5% of the revenue should also be amended. The proposed solution is that revenue can be higher (say, 8 or 10%) for every deal kicked off and completed by local authorities. This will increase the motivation of local authorities to look around for potential bidders and new owners.

7. The government should work more closely with trade unions and the main political stakeholders in the country on implementing the privatization policy.

- Successful privatization is not possible without public and political support. Public support implies that citizens (especially laid off workers) who stand to lose from privatization and economic reforms have the understanding

that the process is necessary, and that they have the patience to hold out until they find another job. For this strategy to work, it is of paramount importance that the government and trade unions work together. The government must strive to reach a consensus on most important decisions, programs, or laws that relate to the losers in the transition.

- In order to strengthen consensus and reduce the social costs of privatization, the government should continue to compensate laid off workers with substantial compensation in terms of generous severance packages, low cost shares, or both. However, since these shares are only rarely going to be of high value in the short run, severance pay and unemployment insurance are likely to be of greatest compensation value.

- The government should abstain from excluding the main political factors from the policy process, for a tendency for arrogance and exclusion could be a double-edged sword in the near future. Serbia is still not a consolidated democracy. If they continue to be sidelined, such forces may attempt to significantly modify the privatization model if they get into the government after the next elections.

- The government does not seem too concerned with both matters. It often and unnecessarily frustrates trade unions by not listening to them in the Socio-economic Council. Privatization is a politically contentious and difficult policy in the best of circumstances. Governments that wish to implement privatization must do their best to build a broad political consensus on the basic objectives and procedures of the program.

8. The work of the agency of privatization should be more transparent and under more effective parliamentary control.

- The agency does not make public its criteria for including a firm in a tender. It also does not always publish the offers that were turned down, but only the offer that won. It is difficult for members of the public to obtain a copy of regular monthly reports the agency writes up for the ministry, and the six-month reports the ministry forwards to the Serbian parliament. Such information should be accessible to the public as much as possible. The agency should make public how the tender committee reaches the decision on whom to sell the firm to. It should publish all rejected offers. The reports should be easy accessible either on the Internet, or on personal demand.

- Since some business people may fear that exposing their losing bids to public scrutiny will give their competitors unfair advantage in how they value assets and business opportunities, the way to achieve this goal, while at the same time protecting confidential business practice, is to use

a “two envelope” system—the first containing all the non-price criteria (e.g. investment and other commitments, or firm information required by the seller); the second containing a price only. The tender commission could examine the first envelope, determine which firms qualify, and then publicly (in Bolivia this was done on national TV) open the second envelope. The best price wins, and other prices are known.

- The privatization law mandates that the ministry of privatization forward to a parliamentary board a monthly report. The parliament is not required to discuss the reports, which is probably why no discussion on privatization has taken place in parliament since the adoption of the privatization law in June 2001. The minister should be obliged to address the parliament at least once a year, whereas the parliament should discuss its annual reports. Understandably, both things should be made public.

- Although in November 2002 the agency set up its web page where lots of useful data on enterprises under or prepared for sale can be found, the abovementioned reports and some rejected bids are still inaccessible. Changes to the law with respect to regular parliamentary hearings are not planned.

Prepared by Ognjen Obućina
A roundtable organized by the G 17 Institute

PRIVATIZATION POLICY IN SERBIA IN 2003

It has been three years now since the privatization process in Serbia was launched under the new model. This period is long enough to make a thorough analysis of the results accomplished so far and to assess what was good, what should have been done in a different manner and what remains to be done in the future. For these reasons, on June 4, 2003, the G 17 Institute organized, a roundtable discussion on the topic of "Privatization Policy in Serbia in 2003". This roundtable is a part of a wider project "The monitoring of Institutional and Legal Reforms". Speakers and participants in the discussion tried to answer the following questions:

- Is the existing privatization model and accompanying legislation good?
- Has the privatization been carried out in an appropriate way?
- What is the relation between the privatization process and the development of the financial market in Serbia?
- What is the current situation on the financial market?

The conference was opened by ***Aleksandra Jovanović***, Head of G17 Institute Department for Institutional and Legal Reforms. Having defined privatization as a basis and the pivotal point of all transition processes, Professor Jovanović gave a brief chronological review of undertaken privatization from 1989 to 2000, when a so called insider privatization was the dominant privatization model.
Dušan Pavlović, a researcher at the G17 Institute, in his speech (available in full in this issue of the Economic Review) gave several recommendations to the government, previously pointing out the developments and results of the privatization under the 2001 law, with detailed information on the enterprises sold and revenue earned. Mr. Pavlović highlighted the question that normally appears in all transition countries, that is, what privatization model should be opted for, and then after the decision has been made, whether it is a good choice. In Mr. Pavlović's opinion, with regard to the experiences of East European countries and to the studies on privatization, there is no doubt that Serbia chose the best privatization model, i.e. the model of direct sale to a majority owner. However, Mr. Pavlović made a few objections in terms of the manner in which privatization has been implemented in Serbia so far with respect to the following issues: 1) there are too many criteria for the selection of the best bid in a tender sale, while, in his opinion, the Privatization Agency should settle on the price as the key criterion by which it sells big enterprises. This is because transition countries experienced cases when agreed future investments (which is one of the four criteria in tender sale) were never realized. 2.) The pace of privatization should be accelerated. The problem of massive unemployment resulting from speedy privatization is exaggerated. 3.) The level of foreign direct investments, which are of crucial importance for the success of privatization, bearing in mind the privatization model ap-

plied and weakness of domestic investors, is not satisfactory. Mr. Pavlović illustrated this with the examples from Hungary, which is regarded as a champion in attracting FDIs, and Slovakia, which, a few years ago after Meciar's government was removed from power, experienced a similar situation as the one in Serbia today. 4.) As far as legislative activity is concerned, Mr. Pavlović said that certain laws should be adopted very quickly, i.e. the Bankruptcy Law and the Law on Investment Funds, as well as the Registry Law, in order to increase demand for enterprises. 5.) A considerable portion of criticism referred to the lack of transparency in privatization. Mr. Pavlović stressed that it is not clear what criterion the Government considers as decisive (price, future investments, social program, and environmental program) for each particular tender sale. The Privatization Agency is not subject to any control, whereby access to relevant reports on the Agency's work is very difficult. 6.) Finally, with regard to social policy, Mr. Pavlović objects to the Government's not working more closely with trade unions in the decision making on the social aspects of privatization. In his opinion, even if a decision is good, it is still made without communication with trade unions.

Boško Živković, President of the Securities Commission, addressed the situation on the financial market in Serbia and the impact of privatization on the development of the financial market. Mr. Živković pointed to the varied success in the development of the financial markets in transition countries, with Hungary and Poland as positive examples, and Russia and the Czech Republic often regarded as negative ones, with these countries often appearing in debates and in literature on the transition. As far as particular privatization models are concerned, mass privatization is hardly associated with the development of financial markets, and in that respect it is inferior in comparison to the model of direct sale. On the other hand, Mr. Živković stressed that the regulation of privatization models and the design of development of financial markets itself are not necessarily decisive factors for success, but the result of privatization measures and measures for the development of financial markets primarily depend on so called fundamental factors, which are, in his opinion, the following: 1) degree of wealth, 2) income level, 3) the structure of market supply, and 4) the structure of market demand.

Mr. Živković also presented the situation in the emerging stock market in Serbia, and stressed that the question is whether we should call this market a stock market at all, because of several anomalies which are currently present. Firstly, share buyers are primarily interested in acquiring ownership control, and therefore what we have today should be better called a market of companies. To prove this, Mr. Živković analyzed the trends of share prices: they reach their peak at the time the controlling block of shares is made, only to drop again. Secondly, demand is insufficient (almost exclusively a demand for companies), while the supply is great, which results in undervaluation of shares. The reasons for such great supply, in Mr. Živković's opinion, are low wages and information asymmetry, which were addressed by other speakers, as well. Information asymmetry exists because citizens – shareholders do not know much about what exactly they possess, which is the result of non-transparency of the financial market and the citizens' ignorance. Because of these factors, shares are traded at much lower

prices than what is considered to be a realistic price. Mr. Živković stressed that undervaluation of shares is typical for all transition economies - Ukraine is the most extreme example in Europe, with the ratio of the price to the book value being 0.1, while in developed countries of our region, e.g. in Slovenia and Croatia, this ratio is slightly over 1. In OECD countries, this ratio is 5.9:1. As far as the ratio of the price to the book value at the Serbian financial market is concerned, Mr. Živković underlined that a relatively good ratio has been achieved on the Share Fund's market, which cannot be said for the market of small shareholders.

Aleksandar Gračanac, Director of the Share Fund picked up on Mr. Živkovic's discussion, giving some details on the performance of the Share Fund so far. He stressed that the objective of the Share Fund, among other things, is to develop the underdeveloped financial market in Serbia. As he said, the Share Fund possesses shares in about 1,500 companies in its portfolio, with their total nominal value estimated at around EUR 800 million. The minority blocks of shares of 94 companies have been sold at the Belgrade Stock Exchange so far, with revenue in the amount of US$ 100 million having been realized. The major problems in the work of the Share Fund, as well as in the development of financial markets in Serbia in general, are inability to cope with the situation and lack of knowledge and of shareholding culture among citizens, as well as absence of the Law on Investment Funds.

Introductory speeches were followed by the discussion. Participants addressed various topics mentioned in the introductory speeches. First participant in the debate was Professor ***Ljubomir Madžar***, Dean of BK University, who did not object to the privatization model itself, but focused on several aspects of implementation of privatization policy. He agreed with Mr. Pavlović that privatization should be carried out much faster, stressing that the argumentation about rapid privatization decreasing the price of enterprises (with the risk of a sharp rise in unemployment being the most frequently mentioned argument against unduly quick privatization) must be taken with reservation. In his opinion, socially-owned and state-owned companies which have been waiting for privatization too long, operate very inefficiently during that "waiting period", which results in further devaluation of the equity of the given companies, which is for professor Madžar a far more serious consequence than the fall in price due to accelerated privatization. Professor Madžar also addressed the problems of the legislative and institutional environment, stressing that high taxes divert potential investors, while better coordination of fiscal and privatization policies would increase demand for companies. He characterized the activities in relation to accompanying privatization legislation as insufficient, stressing that without complementary legislative activity, the very idea of privatization may be compromised.

Edward Hoffmann from the Policy and Legal Advice Center expressed the opinion that socially-owned and state-owned companies which have undergone the privatization process can be called enterprises only conditionally, since they possess real estate and equipment, but are not market-oriented in their business operations. Therefore, investors are buying "the option to make a company". He stressed that it is very important to find a good buyer who is able to make "a real company" out of the purchased enterprise. Mr. Hoffmann also wondered what

are the criteria for the evaluation of the company after it enters the privatization process, as, in his opinion, the main criteria should be the prospects for profit in the following ten years. Mr. Hoffman further stressed that the practice of initiating the bankruptcy procedure in companies should have been started earlier, because many companies which are in very poor condition (in particular heavily indebted companies) are not able to sustain market competition. A positive effect of bankruptcy is a release of know-how, human and material resources from weak companies and more efficient allocation of these resources.

Speaking of the factors that slow down and aggravate privatization, ***Milan Kovačević***, consultant for foreign investments, pointed out that publicly released statistical data is not of high quality, because, although the new Law provides for detailed record-keeping on privatization, it is difficult to get insight into the complete statistics of privatization measures from 1989 to today. Mr. Kovačević first addressed the issue of accounting standards which embodies two basic problems. Firstly, international accounting standards have not been adopted yet, which makes the evaluation of a company more difficult. Secondly, book values of companies are exaggerated. A possible solution may be the audit of a great number of companies. Mr. Kovačević paid special attention to the privatization of public enterprises. Although aware that the process of privatization and restructuring in these enterprises is very complicated and long, Mr. Kovačević believes that what is lacking are signals from the Government on the upcoming privatization measures, because the greatest loss-makers are concentrated in this sector, and, moreover, this sector most often registers practices of soft budget constraints, i.e. the government spends enormous resources to subsidize loss-making companies , which, in fact, are not anticipated to remain in state ownership for a long time, whereby these subsidies are only a short-term help for these enterprises. Activities in the privatization of banks are also unsatisfactory. Moreover, Mr. Kovačević agreed with Mr. Hoffmann that the Serbian economy needs very badly bankruptcy as an instrument. As far as the situation on the financial market is concerned, he does not believe that privatization by itself will have a considerable impact on its development. The Government must start promoting shareholding in order to motivate citizens to take their rainy-day-money (estimated at EUR 4 billion, or even a portion of it) and place it on the financial market.

Dejan Šoškić, Professor at the Faculty of Economics addressed the problem of information asymmetry which results in anomalies in every market, including the financial. The major problem is that insiders, who possess information otherwise hidden from the public and from average citizens, are the main participants in trading in shares. It is not necessary only to inform the citizens and encourage their interest in participating on the financial markets, but they should also be encouraged to place their money there. Professor Šoškić agreed that we need an urgent adoption of the Law on Investment Funds, stressing that investment funds are necessary as an institution of financial mediation on financial markets. It is also necessary to make a clear distinction between shares from privatization and “common” shares, as well as how much time has to pass for a privatization share to become a common share. Professor Šoškić agreed with Mr. Kovačević with

regard to urgency of the adoption of international accounting standards, pointing out that book values of our companies were established in different ways, which leads both to overvaluation and undervaluation of these companies.

Although not ao frequently mentioned in the literature on privatization, denationalization can also serve as a privatization method. Denationalization of firms in East European countries was carried out with varied success, whereby the Czech Republic and Estonia are considered to be the countries which gave most attention to this problem. ***Miroslav Prokopijević*** from the Institute for European Studies stressed that more attention should be paid to the problem of denationalization of firms in Serbia. Also, if we understand the term "privatization" not only as a transition of the existing state-owned or socially-owned companies into the hands of private owners, but also as increase of the share of the private sector in production, than starting up new companies may also be understood as a privatization method. Mr. Prokopijević believes that start-ups in Eastern Europe proved to be much more efficient than privatized companies, and therefore more attention should be paid to the promotion of so called "business start-ups", and not to insist on privatization or on any privatization model as a decisive instrument for efficient reforms. Mr. Prokopijević also stressed that it is uncertain how much revenues the state will collect from the sale of the remaining enterprises that have yet to undergo the privatization process, warning that under the current circumstances, the country is in danger of the "notorious debtor crisis".

Milenko Andžić, editor-in-chief of "Privredni savetnik" put the most emphasis on workers' rights in private companies, and in companies which are yet to be privatized, quoting certain paragraphs of the Constitution (which guarantee equitable treatment of all forms of ownership) and some provisions of the Law on Enterprisers. In his opinion, workers are unjustly neglected in decision making on when, if at all, to start privatization; they are also deprived of their rights in taking important business decisions and in the distribution of profits. Mr. Andžić further stressed that if this problem were successfully resolved, it would, among other things, motivate workers, thus enhancing efficiency. Professor Madžar objected to this position, stressing that liability should determine distribution of governance rights, and consequently, enterprises should be governed by those who took the greatest risk and greatest liability by investing their capital. Professor Madžar stressed that this in no way excludes certain workers' rights in governing the company, but these rights should be defined by the company's owners. Mr. Prokopijević agreed with professor Madžar, but he also added that private firms are reluctant to allow any form of codetermination, using all measures recognized by the law to circumvent it, which he illustrated with examples from Germany.

Participants at the roundtable frequently disagreed on privatization policy, but certain positions can be distinguished as prevailing, containing in themselves answers to the questions from the beginning of this review:

- The existing privatization model is good, but changes in the criteria of selection of the best buyer would be welcome.
- An overall impression is that privatization is unfolding too slowly. The institutional and legislative environment has a negative impact on privatization

since the lack of appropriate laws and exorbitantly high taxes scares off both domestic and foreign investors.

- Privatization itself cannot induce fast and successful development of a financial market in Serbia. In this area it is important before everything else to remove the current information asymmetry, and to interest citizens and encourage them to be more active participants on the financial market. In that respect investment funds would be of great help.

Professor Aleksandra Jovanović, SJD

CORPORATE GOVERNANCE IN THE WORLD AND IN SERBIA

The corporate governance framework and financial systems are shaped by forces and pressures deriving from the character of an economic system and legal regulations (privatization regulations, company law and the law regulating securities and financial markets). The issue of corporate governance has become topical in Serbia because after the coming adoption of the new company law and the already passed privatization laws and the Law on the Securities Market, we will find ourselves facing a choice of the initial form of the financial system and the appropriate corporate governance.

The reform of the corporate governance framework is primarily focused on the reform of company law, as well as on the regulation of financial markets. Privatization laws enforced in transitional economies to a great extent determine the configuration of rights and their economic effects, thus indirectly shaping the initial model of the financial market and corporate governance. On the other hand, legal systems are also the products of different models of corporate governance and of financial systems which have different specific "requests" in relation to legal regulations, i.e. they require a different legal framework. The practical implication of such a link is that only few strict recommendations can be drawn, manly basic principles with regard to the creation and reform of a corporate governance framework and financial systems. This is also confirmed in the OECD Principles of Corporate Governance.

Legal regulations which protect shareholders and shape the model of corporate governance are assessed on the basis of the quality of investor protection and the level of law enforcement. For legal protection of shareholders, the most important criteria are: the rule of law, shareholders' rights which are called antidirector rights (i.e. shareholders are allowed to mail their proxy vote to the firm; shareholders are not required to deposit their shares prior to the general shareholders' meeting; cumulative voting or proportional representation of minorities in the board of directors is allowed; the minimum percentage of share capital that entitles a shareholder to call for an extraordinary shareholders' meeting is less or equal to 10 percent; shareholders have preemptive rights that can be waved only by a shareholders' vote) and voting based on the "one share – one vote" principle.

In a survey[10] conducted to assess corporate governance in several countries it was observed that none of the assessed countries complied with the OECD principles of good corporate governance in all respects. It was also observed that the practice of corporate governance is not often in compliance with an otherwise good and efficient regulatory framework, most frequently because regulatory institutions are weak and because courts do not fully understand how to apply law or are unfamiliar with the issue of economic efficiency.

[10] Freumond, O. and Capual, M., (2002), The State of Corporate Governance: Experience from Country Assessments, World Bank Policy Research Working Paper, 2858, June;

I Corporate Governance, Incomplete Contracting and Information Asymmetry

Corporations are competing to attract investors on the capital market. Efficient corporate governance is reflected in the price of a company's shares, i.e. in company's access to capital market. The systems of corporate governance resolves the problem of how those who invest capital into a company can ensure a fair return on investment. Corporate governance requires separation and protection of shareholders' property rights. Shareholders are entitled to governance rights, and to share in the profits of the corporation (excess profit) and capital gain. There is always a dilemma whether investors are able to assess the price of an enterprise (its equity shares), i.e. what they know about the company. This question is important for efficient allocation of capital. Investors are protected by the law, but without the law, they would protect themselves by assessing the price of the share they buy and/or by contracting provisions to protect themselves from undue risk which is not calculated into the price of investment instruments.

Numerous phenomena related to a company (e.g. ownership structure, corporate governance, financing of the company and financial markets, selection of the structure of the equity, rules of commercial law) cannot be explained by the problems which result from incomplete contracting.

Incomplete contracting occurs because economic actors do not have the same information at their disposal for concluding and realizing a contract. This is called information asymmetry. Secondly, economic actors are prone to opportunistic behavior which is common in contracting relations. Opportunism means that contracting parties use information asymmetry (incomplete, distorted, covert information, different perception). People will always act in their own interest, in spite of the promise given in a contract, if the other side bears the costs of providing expensive information on such a behavior. For example, a manager (or controlling shareholder) will act in his/her own interest as long as the high costs of revealing information about such behavior rest with minority owner of the company.

In company theory and company financing theory, the approach of incomplete contracting, starting with the protection of investors, is focused on the relation of ownership and control over a company. Ownership and control do not necessarily coincide. Separation of these two functions may result in the structures of corporate governance which are not based on ownership (such as a fiduciary, coalition). Contracts and/or laws therefore should make possible control over a company in a way that reconciles the interests of different contracting parties in a company. Information asymmetry and opportunism of different parties produces information (transaction) costs which affect the market value of a company.

Economic and legal institutions serve to reduce two major and frequently intertwined types of costs based on information asymmetry: the relation between shareholders and managers and the relation between controlling and non-controlling shareholders.

II Corporate Governance Deals with Two Types of Information Asymmetry

II1. The Separation of Ownership and Control: Relation Between Shareholders and Managers

The governance of a company and utilization of resources within a company may be a problem. Managers and some categories of employees (not all of them) as team members are in a position to have better knowledge of the organization of work, the characteristics of resources used, how they are being used and maintained, etc. Owners of corporations, if they are outsiders, do not possess such information, and this information asymmetry may affect managers who need not always act in line with the maximization of profit. Therefore the behavior of managers may direct a portion of profit to themselves, but this still means a smaller loss for owners than if owners run the company themselves. At the same time some shareholders may act as managers. The shareholders participation in management reduces the agency problem of separation of ownership and control, but at the same time increases the problem of separation of the right to return and to private benefits resulting from control.

The costs of supervision and control over managers are increasing and after a certain point they exceed the benefits the owners may have with regard to the protection of their investment. Namely, owners do not have the know-how, while limited liability does not stimulate sufficiently control over managers because limited liability allows diversification of risk by putting investments in several enterprises. Free trade in shares, however, allows a cheap form of control of managers. On the capital market, each managerial decision is assessed and then expressed through the price of shares. Every drop in the price of shares gathers the shareholders together against managers. Owners replace managers, and if this is not possible, they can sell their shares to those capable of appointing more efficient management. Managers bear a high risk since their investment in knowledge and skills of managing the company is actually an investment in specific human capital which cannot be diversified in different companies. It is hence very important for them to keep their employment, and they are therefore going to make decisions that will increase the market value of shares, thus maximizing the welfare of a company's shareholders.

Managers run the company's affairs, they know how the company operates and they can hide much information about the company and about their own activities from the existing and potential investors. Divergent interests of managers and owners are always present. They are expressed as the principal-agent problem, i.e. opportunistic behavior of managers in the realization of promises contracted with a company's owner. The principal-agent problem results from information asymmetry which makes it difficult for two parties to define their contracting relation so that both of them are able to realize contracted promises.

II 2. Divergent Interests of Controlling and Minority Shareholders

All shareholders are protected, but shareholders are not a homogenous group, and hence their share in a corporation determines the level of protection which they expect to be defined in the corporate statute or charter. Hence, the same level of protection is not required for controlling shareholders and for minority shareholders who do not control the company.

II 2.1. The Separation of Ownership and Control: Private Benefits From Control and Control Premiums

The concentration of ownership and the appropriate corporate governance framework which leads to the separation of control and participation in the profit of a company is achieved thorough various economic and/or legal instruments: multiple classes of shares (deviation from the principle "one share-one vote"), cross shareholding, pyramidal ownership structures through take-overs and through shareholders' participation in a company's management. The most important mechanism, according to empiric indicators, is the establishment of a pyramidal structure.[11]

Empiric results confirm that family holdings and governments are the most common categories of controlling shareholders, while control by banks through owning shares is not that frequent. Only 5% of big corporations are controlled (mainly) by banks and other financial institutions. Control by banks is more common in countries with weak shareholder protection as compared to countries where the shareholders are well protected. Banks as shareholders are not very frequent outside Germany, Belgium and Japan. Thus, the ownership of financial institutions does not play any significant role in corporate governance, although in Germany and Japan banks possess significant power in corporate governance through their seats on corporate managing boards or through voting shares of other investors.

Concentrated ownership (big shareholders) reduces the possibility of diversification of risk. That is why investors tend to extract **private benefits** from the company. Thus, the control pursued by majority shareholders (insiders such as a director or a family holding in Italy) is determined by the influence of private benefits. The conflict of interest between minority and majority shareholders cannot be avoided. The interests of majority and minority shareholders are not likely to be harmonized when it becomes necessary to carry out the transfer of control.

The data from Italy confirms that majority shareholders enjoy huge private benefits not smaller than 1% of the total market value of a medium-size corporation from the sample. Private benefits of majority shareholders discourage external investors from offering capital to the company. Therefore the costs of a conflict between majority and minority shareholders may be reflected in the drop in the

[11] Results La Porta,R., Lopez-De-Silanes,F. and Shleifer,A.(1999), **Corporate Ownership Around the World**, The Journal of Finance Vol.54, No.2., are consistent with Barka,F., (1996), **On Corporate Governance in Italy: Issues, Facts and Agenda**, Nota di Lavoro 10.96, Fondazione Eni Enrico Mattei.

global value of the company and the consequent decrease in the value of its shares. Empiric data confirms the assumption that private benefits deriving from controlling rights are much more important if the protection of shareholders is weak.

Weak protection of minority (non-controlling) shareholders reduces outside financing and consequently stock markets are smaller and managers are under less efficient control in the market for corporate control. Hence, the development of financial markets (the level of capitalization and liquidity of the stock exchange) is positively correlated with legal protection of shareholders. Italy, France and Germany have relatively small stock exchanges.

Corporations usually do not deviate from the “one share-one vote” principle, even where it is legally possible. Results show that multiple classes of shares are not the main method for the separation of ownership and control. Cross shareholding is also not of significance for the separation of ownership and control, except for Germany and Sweden. Cross shareholding seems to be more significant in countries where it is prohibited. The separation of ownership and control is of practical significance because controlling rights possessed by controlling (majority) shareholders may be in considerable disproportion with their right to participate in corporate profits.

On average, 18.6% of capital is necessary to exercise control over 20% of votes. In countries with poor shareholder protection, 17.7% of capital on average is necessary for control of 20% of votes, while in countries with strong protection of shareholders 19.7% of capital is necessary for the control of 20% of votes.

Considerable data on trade in shares with substantial premiums confirms that control over a company has its own value. The level of a control premium (voting premium) changes according to the level of the possibility for managers or controlling shareholders to gain benefits. The premium ranges, as shown by the data, between 6.5% in Sweden and 82%, a premium measured at the Milan Stock Exchange. On the other hand, as a consequence of the wider dispersion of ownership or modest concentration, superior voting (controlling) rights in the USA are traded at small premiums. The prices of companies incorporate the effects of ownership and corporate governance on the future success of the company.

III Shareholder Protection– Legal and Economic Instruments

The protection of shareholders requires a well balanced relation between protection instruments and instruments which improve and enhance control. The overprotection of investors who do not control a company allows them to interfere in control which may reduce the incentive for efficient behavior of those controlling the company. On the other hand, underprotection of investors, especially non-controlling ones, reduces their incentive to offer capital because of the disturbed efficiency of transfer of control. Hence, it cannot be simply concluded that wider legal protection of investors is always desirable because it develops financial markets. Legal overprotection reduces entrepreneurial innovation activity and efficiency. Accordingly, optimal legal protection is complementary to economically efficient protection instruments. A combination of certain economic and legal in-

struments (e.g. concentrated ownership and control by a big shareholder, with smaller and narrower financial market and with weaker legal protection of investors) and their efficiency is a substitute for some other combination of economic and legal instruments (dispersion of ownership with a liquid financial market and with good legal protection of investors).
Complex institutional structures – economic and legal – act together to restrict contracting parties in their opportunistic behavior, i.e. to reduce information asymmetry and minimize information (transaction) costs resulting from incomplete contacting. Hence, besides legal protection, shareholders are finding economic methods and instruments for coordination of interests of managers and shareholders and/or controlling and non-controlling shareholders in order to discourage both managers and controlling shareholders from appropriating the portion of a company's profits which do not belong to them. These methods are different, varying from the ownership structure (concentration or dispersion), the structure of corporate governance (family holdings, pyramidal structures, block alliances, obligation to pay out dividends, threats of company takeover), the structure of capital (the relation of debt and ownership financing, the risk of bankruptcy), the type of financial market, as well as, for example, whether the managers' remuneration depends on the company's performance.
Legal systems are equipped to regulate the problems coming out of information (agency) problems in different ways, each of them being related to certain costs and benefits. Legal instruments provide security for investors, in particular, for minority (non-controlling) shareholders.

IV Corporate Governance and Financial Systems

Economic theory distinguishes two models of financial systems: **Anglo-American market-oriented model** and **German bank-oriented model**.
The Anglo-American market-oriented model for a financial system is associated with dispersion of shares. In this model, the majority of financial institutions are not allowed or are not willing to play any significant role in corporate governance. Dispersion of ownership developed the stock market which has become an instrument for the battle against opportunistic behavior of managers, and the threat of company takeover has become a synonym for corporate governance. Under this model, ownership is dispersed among a large number of individuals and institutional investors as outside owners, whereby cross shareholding is not very common, and takeover activity is very lively.
The German bank-oriented model for a financial system is associated with concentrated ownership. Banks and financial institutions play a significant role in corporate governance through the ownership of a corporation's shares or through pursuing the right to vote on behalf of investors/shareholders. This is the insider system in Continental Europe and Japan, where the ownership of individual corporations is in the hands of a small number of family holdings, banks and other companies, and where cross shareholding is usual. However, as opposed to expectations implied by the difference between the two models, in the major part of the world large companies usually have a controlling shareholder. Neither in the

USA is there a complete dispersion of corporate ownership, and concentrated ownership is much more frequent than expected.
As opposed to the widely held belief that big corporations are owned by a large number of shareholders, surveys confirmed that only a few big corporations are owned by a large number of shareholders in countries with weak shareholder protection. In countries with good legal protection of shareholders, such as the countries of the common law tradition, corporations owned by a greater number of shareholders are more frequent (dispersion of ownership is more frequent), and consequently these countries have greater and more liquid stock markets. However, regardless of the model of a financial system, the biggest corporations tend to have controlling (majority) shareholders, with the exception of the USA. However, even in the USA the largest corporations record a moderate concentration of ownership, contrary to the common impression that they have numerous owners.
A considerable concentration of ownership is registered in Germany, Japan and Italy, while strong concentration of ownership is common in developing countries.

V Costs and Benefits of Different Models of Corporate Governance

A dispersion of ownership provides less incentive for shareholders to supervise managers because of the problem of free riding. Supervision costs are higher than the expected supervision benefits. Free riding may prevent the transfer of control over a company into the hands of those who would be the most efficient managers. Possible protection is the sale of shares, including takeovers and replacement of managers and the system of fiduciary obligation which requires the board and managers to act in the interests of those owners who do not have control.
Concentrated ownership alleviates the problem of free riding in corporate control, and consequently owners are more active in controlling managers. Big shareholders have real incentives and skills for supervising managers. However, there are different types of big and active shareholders; hence different corporate governance options are applied. On the other hand, concentrated ownership reduces the possibilities for diversification of risk which makes the provision of capital from outside owners much more difficult, especially of the capital of small shareholders.
According to empiric results, as far as the relation between concentration of ownership and the success of a company is concerned, corporate success increases with lower levels of concentration of ownership and drops with high levels of concentration. The general implication of many models of corporate governance is that companies with more concentrated ownership, providing that other characteristics remain the same, sell their shares at higher prices because of the incentive of one number of owners to supervise the company and make the necessary changes in the management.

V 1. Corporate Governance and Privatization

One of the main reasons behind privatization is increase in the efficiency of corporate operations of a company, which is achieved through the restructuring of the company – its management, organization, status. Such a restructuring is possible only if privatization establishes a system of corporate governance which leads toward the restructuring of the company, and consequently its more adequate response to market signals through the change in the employment level and the relation between capital and labor, reduction of costs, increase in productivity and better quality of supply. Ownership by external owners is superior in short-term restructuring relative to ownership by insiders – i.e. employees and managers. Insiders are stimulated to reduce costs of non-working inputs, but not of working inputs, which jeopardizes a company's adjustment.
Long-term restructuring is reflected in the adjustment of a company's size, change of internal organization, introduction of new technologies and investments. The ownership of outside shareholders, due to their consistent for-profit orientation, is superior also with regard to long-term restructuring.
The Privatization Law set out the initial structure of property rights. It is not insignificant from the viewpoint of the restructuring of a company what legal model of privatization will be dominant because it determines the initial structure of property rights. Namely, a company's shareholders bear the risk and are stimulated to control the behavior of the company, i.e. the decisions of the managers. Control may be active (direct, as with personal involvement) or passive (as in joint stock companies), through institutional investors and financial markets (on which potential future owners appear) which will force managers to make efficient decisions so as to maximize the value of the company.

Changes in the behavior of a company depend on the introduction of a new system of governance. Not all forms of private ownership (employee ownership, managerial ownership, outsider ownership) are capable of establishing easily and quickly the new system of governance in companies, which will change their behavior. The initial structure of property rights established through privatization is subject to gradual changes. The optimal initial structure of property rights cannot be determined in advance – dispersion or concentration, and inside or outside ownership. It will be changing through constant movement of resources toward those able to use them in the most profitable way. The role of legislation concerning the economic system is to remove obstacles in the exchange of property rights (to reduce transaction costs) and to ensure conditions for the development of financial markets.
The degree of dispersion, i.e. of concentration of ownership depends on what is the dominant type of private ownership. Some types of private ownership (the structure of property rights) offer the company's shareholders wider incentives to pursue changes within the company – i.e. reorganization and restructuring that will increase its efficiency.
The structure of property rights is established on the basis of the privatization law, which is reflected in various types of private ownership or their combination

in enterprises – employee ownership, managerial ownership, outside (external owners') ownership which includes the ownership of foreign investors.
The domination of employee ownership in companies is an obstacle for easy restructuring. Due to the dispersion of equity shares, employees can hardly pursue efficient control of the management's decisions. Moreover, they are primarily interested in preserving their own jobs and will very reluctantly sell their shares to external investors who could leave them jobless through restructuring. Since they are employees and owners at the same time, they have conflicting interests with regard to decision-making in terms of whether to increase the company's property or to increase their salaries. This results in inefficient allocation of labor. Moreover, they do not possess the necessary capital for capital increase, while external owners also invest reluctantly because of possible conflicts with employees.
Most often managers appear as the company's owners, together with employees of non-managerial occupations. Managerial ownership means that managers are the majority shareholders. As in the previously described model, this one also involves insider ownership, and it is true that bad managers are prone to hide information, direct the benefits of business operations in their direction and block the sale of shares and the creation of critical concentration of ownership of outside shareholders which would facilitate control and the disciplining of managers. There is no threat of their dismissal and they are therefore stimulated to undertake risky actions since they can transfer risk to creditors. The experience of market economies shows that 5-10% of managerial ownership can be optimal for managers to act efficiently.
Outside shareholding, depending on the privatization model, may appear as concentrated or in the form of a great dispersion of shares. The ownership of outsider shareholders as a rule stimulates shareholder control of managers, and the company has easier access to the capital and necessary expert know-how for reorganization and restructuring, especially where foreign investors are concerned. Wide dispersion of this type of private ownership supports the development of a secondary securities market, but may also be an obstacle for the control of managers and for the restructuring of a company, if the company is owned by too many small shareholders. For a revision of such an initial structure of property rights, it is necessary that the privatization law and legislation regulating securities and stock exchange operations does not limit the sale of shares. The control and disciplining of managers, and consequent restructuring of the company will be also achieved in the situation of a dispersion of shares through the setting up of investment privatization funds and other institutions that may manage someone else's portfolio. This form of concentration of control of a company and its managers is not covered by the existing legislation.
It cannot be established in advance what initial structure of property rights is efficient. An efficient structure of property rights should be established on the market. Each company, depending on its type and size, has a different optimal structure of property rights, with regard to economic features of certain forms of private ownership (employee ownership, outsider ownership, managerial ownership, dispersion or concentration of ownership). This means that the new struc-

ture of property rights will enable the shareholders to carry out reallocation of all resources within the company and market-wide by pursuing adequate control of managers/decision-makers. Such restructuring will bring about changes in costs, the capital-labor ratio, the ability to providing capital, growth in productivity and quality of products, change in relative prices and change in the structure of production. Some enterprises or their plants will be closed down, but on the other hand, there will be expansion of new companies and growth of remaining ones. Hence, the initial structure of property rights determines the speed and cost of corporate restructuring. The initial structure of property rights will probably not be optimal in all companies in terms of dispersion being too wide, or of certain categories of shareholders gaining ownership, and then blocking necessary changes in the company.

Besides establishing adequate mechanisms of control of managers, corporate restructuring is also reflected in the shaping of new organizational forms of a company, new internal organization, as well as its new, optimal size (closing down of certain parts). After privatization, each company (its shareholders and managers) will choose (contract) an organizational form, a managerial structure, internal organization and size that are the cheapest for doing business. The speed and costs of restructuring, again, depend on the initially established structure of property rights and the possibility of their exchange with minimal information obstacles.

VI Corporate Governance and Shareholder Protection

According to vast empiric literature, differences in legal protection of investors to a great extent explain variations present in corporate governance and financial systems in the world. In these surveys, legal regulations are assessed according to the quality of legal protection of investors and to the level of law enforcement. However, in spite of these differences, some countries show a similar level of economic development. They show that the level of external financing depends on the level of legal protection of investors, and not, contrary to expectations, on whether the countries in question belong to bank-oriented or market-oriented financial systems.

Differences in company laws in the world do not necessarily imply different investor protection. On the other hand, there is evidence (sample comprising 49 countries) that differences in legal regulations with regard to the protection of investors affect the development of financial markets and the approach of companies to external financing. In the case of legal regulations which protect the investors poorly, their inefficiency is more or less successfully substituted (compensated) through economic means, such as greater concentration of ownership and/or by the choice of the structure of capital (the ratio of debtor and owner capital), and/or by the manner of corporate governance (family holding, block alliances, pyramidal group), and/or by the type of financial market. “Different rules and institutions may be substituted well and can be mutually complementary to yield the

same result"[12]. A similar development level of G-7 countries which belongs to different legal systems may be understood as a result of institutional substitutions. The USA and Great Britain are countries of the common law tradition and their legal systems offer the best legal protection for investors. Another four countries belong to European civil law, whereby France and Italy belong to the French civil law tradition, and Germany and Japan to the German civil law tradition, which is, in terms of investor protection, halfway between the common law system and the subgroup of French civil law tradition. Canada is characterized by bijuridism, i.e. parallel legal systems – common law and civil law are enforced in different regions of this country.

The results confirmed a strict correlation between legal protection of investors, concentration of ownership and liquidity of financial markets. Common law countries offer the best protection of investors and have developed financial markets. Among the countries of the European common law system, the French subgroup offers the poorest protection, while the German and Scandinavian countries are halfway between common law protection and the French subgroup.

With regard to differences between common law and European civil law traditions, in our opinion, weaknesses in legal protection of investors in the countries of the European common law tradition, and consequently less developed financial markets may be compensated by the reduction of information costs because of the existence of large (concentrated) shareholders. Smaller and less liquid financial markets and developed financial markets serve different purposes. For example, countries with more developed financial systems register superior growth in capital-intensive sectors because these sectors naturally rely on external financing[13]. Also, preliminary data on the success of different models of corporate governance in Italy confirm that some models are more successful in certain sectors. Thus, the control of family holdings and block alliances yields better results in traditional and specialized sectors. Group control is better for the sectors of high technology where huge investments are needed. This proves that companies associated in groups are less limited financially. Also, this means that the control of a pyramidal group acts as a substitute for financial institutions.

VII Transition Economies, Corporate Governance and Financial Systems

The following questions need to be answered: what is the purpose of different structures of corporate governance and financial systems. Each of them is associated with different costs and benefits, comparative advantages and shortcomings. Each system provides different instruments for the reduction of opportunistic behavior.

[12] Berglof,E.,(1997), **Reforming Corporate Governance: Redirecting the European Agenda**, Economic Policy, April.

[13] See Rayan,R. and Zingales,L.,(1998), **Financial Dependence and Growth**, American Economic Review, No.88.

Transition economies have been relying on various privatization models for political reasons. Consequently, different structures of financial markets and corporate governance have been created. In the majority of transition economies, capital markets are still underdeveloped. Insider privatization and consequent insider shareholding (employee and managerial ownership) proved inefficient in the restructuring of enterprises. In Russia[14], for example, majority shareholders are managers whose property rights included the right to share in the profits of the company, together with nearly full right to control. The experience of the Czech Republic[15] implies that control by banks and funds plays a significant role in corporate governance. Direct sale is the only privatization method which unambiguously creates efficient managerial structures in enterprises.

Progress in development of institutions in the area of financial markets requires stronger legal protection of investors, with special emphasis on adjustment of the regulation of a banking system to international standards, strengthening of bankruptcy legislation, modernization of company and securities legislation, and improvement in the application of law. A close relation has been noted between improvement in regulation of financial markets, restructuring of enterprises and corporate governance with promotion of foreign investments and credits. As shown by experiences of transition economies, the problem with legal regulations is predominantly present in the area of application and not in the quality of these regulations. To avoid the pitfalls of the established structures of corporate governance, as well as to ensure privatization proceeds, governments apply different methods of privatization that remains to be carried out – direct sale through tender and auction sales. This is also the experience of Serbia.

Also, to improve the ownership structure and corporate governance which results from the earlier voucher and MBO/EBO privatization, governments have tried to promote restructuring of companies through the introduction of the Anglo-Saxon model of a market for corporate control and through external financing. Such institutions did not work well in many countries. Modern laws have been adopted, but their enforcement depends on ingrained legal traditions and knowledge of business people and legal experts. The quality of law cannot, therefore, be chosen on the basis of desired results, but according to economic forces and the pressures they exert within the system and according to the given legal tradition.

The most important commercial laws were expected to get closer, in terms of their contents, to internationally accepted standards, and to reach internationally accepted levels of enforcement. On the other hand, the legal framework for emerging market economies should be consistent with legal tradition and the level of economic development of each country. The necessity for consistency explains why the adoption of new legislation which is not close to legal tradition of a given country reduces the level of enforcement of that law[16]. The problem is that judges and legal professionals in transition economies should acquire

[14] Boyko,M., Schleifer,A. i Vishny,R.,(1995), **Privatizing Russia**, M.I.T. Press, Cambridge Mass

[15] Classens,S.,(1997),**Corporate Governance and Equity Prices: Evidence from Czech and Slovak Republilics**, The Journal of Finance, Vol.52, No.4

[16] See Pistor,K., Raiser,M. i Gelfer,S.,(2000),**Law and Finance in Transition Economies**, The Economics of Transition, Vol.8, No.2

knowledge on how to apply sophisticated rules and to understand the new way in which the economy functions.
Hence, empiric results suggest that the application of law is much more important for the development of financial markets than the quality of the law itself. Also, the choice of legal regulations should be in compliance with legal tradition, but also with the wider cultural tradition of each country.

VII 1. Corporate Governance and Privatization in Serbia

Different ownership structures and models of corporate governance imply the development of financial markets. Since privatization philosophy has changed as of mid 2001, and the new concept relies on the establishment of majority-controlling shareholding, namely, on concentration of ownership as well, the dominant type of corporate governance and the financial system has been implicitly redefined. With regard to these changes, it should be borne in mind that if concentrated ownership prevails, then financial instruments will be held by a smaller number of investors, which results in reduced liquidity of financial markets. And conversely, low liquidity of financial markets may conserve the existing concentration of ownership. Moreover, low liquidity of the market may also perpetuate the existing, inadequate protection of investors. Concentration of ownership is negatively correlated with legal protection of shareholders. Development of financial markets is positively correlated with legal protection of shareholders.
Given the dominating privatization model under the earlier privatization legislation (1989, 1990, 1991, the 1994 revision, 1997), the prevailing ownership structure in privatized enterprises was employee ownership. It is stressed that today in Serbia there are about 1.000.000 shareholders. The remaining non-privatized equity shares of companies which have not completed their privatization are in the portfolio of the Share Fund and will be sold mainly through auctions. On that basis, the Share Fund holds, on average, 10-60% of capital of 1.500 companies which have started privatization under former legislation. On the other hand, under the positive 2001 Law, 30% of equity that remained after tender privatization will be transferred free of charge to the employees, former employees and pensioners, which will enable dispersion of ownership. Also, another 15% of equity shares remaining after tender privatization are foreseen to be transferred free of charge to adult citizens, which is a basis for dispersion of ownership. Hence, only after the completion of the privatization process will we be able to define the ownership structure, the degree of ownership concentration and the degree of ownership dispersion in companies, as well as the dominant type of corporate governance. Until then, we assume that concentrated ownership will dominate, given the combination of the prevailing ownership structure achieved and the level of privatization realized under former privatization laws, and the ownership structure which may be achieved under the 2001 Privatization Law.
It is interesting that the Share Fund, although collecting dividends on the basis of transferred shares pursuant to the Law, is not entitled to exercise the right to governance on the basis of these shares. This is an unusual provision since it separates the right to share in the profits of the company and the right to govern-

ance, thus building a bad foundation for corporate governance in this transitional period, although it concerns a provisional period until the sale of the transferred shares (the term of six years). Hence, the control of corporate governance in these enterprises cannot lead to structural changes and improvement of efficiency.

In any event, for the analysis of corporate governance and its impact on efficiency and mutual competitiveness of companies and on competitiveness of the economy as a whole and of development, it is much more important to focus future research on the following questions: the degree of ownership concentration in big enterprises (whether there exists a controlling shareholder with at least 20% of direct or indirect ownership in the company, i.e. dispersion of ownership), the structure of corporate governance (family holding, block alliance pyramidal structure), the structure of capital in the company and access to external financing. For the time being, in an economy which is not fully privatized yet, when we do not have precise data on what percentage of that economy has been privatized so far and what kind of ownership concentration has been established and what is the structure of corporate governance, it is difficult to give a final assessment on what else can be done through regulations as legal determinants of this process. Namely, the legal tradition together with economic forces and economic characteristics will certainly have a decisive impact on shaping the financial system and the corresponding corporate governance framework in our country. Given the changed privatization philosophy in Serbia and a trend toward dominantly concentrated ownership and the corresponding system of financial markets and corporate governance which incline toward the German model, it seems that we are getting closer to the financial system and corporate governance framework which fit better our legal structure and legal tradition.

Corporate governance is certainly one of the determinants of efficiency of a company, of the price of its financial instruments, and hence of its attractiveness for investors and its competitiveness. Until privatization ends, it is hard to qualify its impact on competitiveness and other indicators of successfulness. Good corporate governance is an incentive for managers and/or controlling shareholders to make decisions that are acceptable for all (including non-controlling) investors with a view to encouraging investments. Good corporate governance reduces transaction costs within an enterprise and on the markets, thus stimulating investors to offer their capital.

VIII There Are no Strict Recommendations in the Reform of Corporate Governance

Legal protection of shareholders in the world ranges from considerable protection that includes mandatory and default provisions which are applied in cases not regulated otherwise by statutes, to the protection which for the most part relies on procedural rules. The optimal protection level and consequently the best structure of company law is based on practice that shows that facilitating and procedural rules have greater effect against opportunism than mandatory rules.

It cannot be easily said what system of corporate governance is better in spite of variations in them based on different financial systems. They are associated with different costs and benefits and serve different purposes. Although classified according two different financial systems, differences between Great Britain and the USA, and Germany and Japan are much smaller than the differences existing between these four countries and most other countries. Most of the systems of corporate governance and corresponding financial systems in the world are not found in the most successful systems – i.e. in the USA, Great Britain and Germany. Most of the systems are similar to the financial system of Italy, which is characterized by weak protection of investors. In the majority of corporate governance frameworks and financial systems, companies are under the control of family holdings (and governments), and have problems in providing outside financing. The majority of systems are based on weak legal protection, where instruments such as concentration of ownership and insurance of a family holding's control are substitutes for weak legal protection of shareholders. And conversely, concentrated ownership "requires" only basic legal protection. Legal protection is only one dimension of protection against opportunistic behavior. Corporate ownership (concentrated or diffused), corporate governance, corporate financing and corresponding financial markets, for their part affect the creation of the legal system. Evolution of a legal system is the result of the action of economic forces. Economic forces shape legal regulations and *vice versa*. The quality of laws cannot be chosen on the basis of desired results, but in accordance with economic forces and their pressure within the system and the given legal tradition. The freedom of economic and legal policy makers is limited by informal institutions, social norms and social values, which result from the fact that legal regulations are not sufficient to design the desired ownership structure, the desired system of corporate governance and financial markets. In general, a better system does not exist, but what does exist is a system that is better for achieving desired purposes.

A Roundtable Organized by the G 17 Institute

INSOLVENCY LEGISLATION IN THE LIGHT OF ECONOMIC AND LEGAL REFORMS IN SERBIA AND THE DRAFT LAW ON INSOLVENCY

On April 11, 2003, the G 17 Institute organized a meeting of experts on the topic ***"Insolvency Legislation in the Light of Economic and legal Reforms in Serbia and the Draft Law on Insolvency".***

The conference was opened by ***Aleksandra Jovanović***, Head of the G 17 Institute's Department for Institutional Reforms, who noted that this conference is a part of a wider project "The Monitoring of Institutional and Legal Reforms", which is funded by GTZ, a German organization for technical cooperation. In her opening speech, Professor Jovanović stressed that there are two critical moments in the life of each enterprise, i.e. starting up and closing down of business. Certain costs are involved in starting up a business which are determined, among other

things, by the costs of closing down, and because of this, mechanisms for closing down a business are important for each kind of investment, i.e. credits, equity funding, as well as privatization. Good insolvency legislation provides for the procedure of both liquidation and reorganization, it resolves the problem of transferring control to creditors before the entire property of one company goes bust, it makes possible for insolvent companies to use closing down mechanisms, and for "ill" but potentially "alive" companies to undergo restructuring. Change in insolvency legislation means that the significance and importance of good mechanisms for possible closing down of business are finally taken into consideration. Our reality is that out of 34,200 illiquid legal entities (which employ 468,000 workers) that were registered until December 31, 2002, 29,000 enterprises filed for bankruptcy, but insolvency proceedings were opened in as few as 575 enterprises (figures released in the magazine "Ekonomist", March 31, 2003). In Professor Jovanović's opinion, the non-application of bankruptcy is a gross disrespect of market behavior, despite the fact that under current regulations, bankruptcy proceedings are too expensive, lasts too long (5-10 years) and do not stimulate creditors.

Insolvency legislation is complementary with privatization and stabilization of economic policy. It is therefore a necessary component of the transitional reform processes. This meeting of experts was organized as a continuation of an already initiated public debate on new insolvency legislation, with special emphasis on the assessment of economic and legal effects of the solutions offered in the Draft Law on Insolvency, Professor Jovanović concluded.

Time and Regional Framework of the Adoption of the Insolvency Law In Serbia and its Main Features

Vesna Rakić Vodinelić, Director of the Institute for Comparative Jurisprudence and Professor at the Faculty of Business Law in Belgrade discussed the timeframe and the regional framework for the adoption of the Insolvency Law of Serbia and the main features of that Law.

For the sake of better understanding of the current position of Serbia with regard to insolvency legislation and of the features of the new Insolvency Law, Professor Rakić Vodinelić gave a brief overview of historical development of bankruptcy law and of some codifications which had a decisive effect on the development and today's approximation of regional insolvency laws.

Professor Rakić Vodinelić began the historical overview of the development of bankruptcy legislation with the XVI century, referring to it as "the first great wave of bankruptcy legislation" after the period of application of Roman law. The first rules on bankruptcy in the form of bankruptcy law were adopted by municipal authorities in Antwerpen, the Netherlands, in 1515, with the aim to prevent debtors from fleeing the territory of the Netherlands, as this town was the center of world trade. From than on, bankruptcy legislation started spreading across Europe: in 1532, Charles V adopted the Bankruptcy Law for the whole territory of the then Netherlands; in 1536 Francis I adopted the Bankruptcy Law for the then France;

in 1542, Henry VIII adopted the Bankruptcy Law that was enforced in the then Great Britain. This legislation had, *inter alia*, the following common features: 1.) the debtor was, as a rule, considered to be a criminal offender and charges were pressed against him for bankruptcy; 2.) consequently, bankruptcy was considered a disgrace for the debtor, and it discredited him in his future business life.

The next great wave of bankruptcy legislation took place in the XIX century, bringing about, alongside the idea of the disgrace of the debtor, a new idea of rehabilitation of the debtor in the form of reorganization of his business. European states reformed their bankruptcy legislation, while the first bankruptcy laws were enacted in East Asian countries. The idea of reorganization of the debtor, which has survived up to the present day, and which has been increasingly developing and dominating in bankruptcy legislation in general, appeared in the USA for the first time for purely pragmatic reasons. The essence is that liquidation of the debtor must not be allowed because of the enormous social damage it creates, and that it is better to help the debtor recover through the process of reorganization, which is an integral part of insolvency proceedings.

The XX century marks the beginning of a new global wave of reforms of insolvency legislation, which still continues. Year 1978 is especially important because the Bankruptcy Reform Act was enacted in the US, and the entire Chapter XI of this document deals with the reorganization of the debtor, i.e. its recovery through more or less compulsory measures for reorganization which are undertaken by the court and other relevant institutions. This Act is still very influential, inspiring reforms of insolvency legislation worldwide. Professor Rakić Vodinelić stressed that of greatest interest to us is the reform of bankruptcy legislation carried out in CEE countries. The experiences of these countries shows that the application of insolvency criteria from Western European legislation (the USA, Canada and other developed countries) in the countries in transition results in the bankruptcy of almost the entire economy (e.g. in Moldova). Hence, the idea of reorganization was very well received in the transition countries.

The characteristic of the XX and the beginning of the XXI centauries is an international and regional approach to insolvency legislation. International and regional organizations have been putting great efforts into shaping the models of insolvency legislation that are applicable everywhere in the world, among which, in Professor Rakić Vodinelić's opinion, the most important and the most relevant are the attempts and models created by the IMF, the World Bank and the UNCITRAL. More precisely, the IMF and the World Bank do not have a complete and comprehensive model of insolvency law, but they only give certain guidelines for the reform of insolvency legislation, including techniques for the implementation of changes. Unlike these organizations, the UNCITRAL released a publication which contains a concept that could be referred to as the model of insolvency law. Besides these initiatives of international organizations, Professor Rakić Vodinelić pointed out to some regional initiatives for the harmonization of insolvency legislation, in particular the initiatives for harmonizing bankruptcy with international elements, i.e. international bankruptcy. Owing to globalization, international bankruptcy is an increasing phenomenon; international bankruptcy prevails over bankruptcy with internal elements, even in the EU Member States.

Among the oldest regional conventions on bankruptcy is the one signed as early as 1648 between the Hanseat towns, i.e. towns in Northern Germany which were always markedly trading towns. However, a much more important year is 1960, when authorities in the then European Economic Community began working on rules on international bankruptcy that would be applicable in the entire Community, with the result being the Convention on International Bankruptcy in the European Community; the text of this Convention, was transformed into the EU Directive which came into effect as of May 2002. There are also other regional integrations which share common principles or rules of international bankruptcy: the regional initiative of the USA, Canada and Mexico (NAFTA) and the regional initiative of 16 countries of Central Africa. Such initiatives are present in the states of Eastern Asia and South America, as opposed to the Balkans, which still do not have any initiative for harmonization of international bankruptcy rules between the Balkan states.

In that sense, Professor Rakić Vodinelić discussed the Draft Law on Insolvency, pointing to some novelties of legal and political character. Professor Rakić Vodinelić stressed that this is a version of the Insolvency Draft Law from February 2003, which was initially created for the federal state, i.e. for the purposes of the Federal Ministry of Justice, but after federal prerogatives were transferred to the Member Republics, this Draft Law was adapted to conform to the needs of a republican law, since Montenegro already has the Insolvency Law.

Professor Rakić Vodinelić pointed to some of the main characteristics of the Draft Law. The first characteristic concerns the model on which this Draft Law relies. A direct model for this Draft Law on Insolvency is the German Insolvency Law from 1999, which radically changed German insolvency legislation which had been based on the principle of liquidation of the debtor, but with the 1999 Insolvency Law, it accepted the idea of reorganization with a stronger role of the trustee in insolvency. Croatian legislator used this Law as a model to an even greater extent, since it literally translated certain provisions. Slovenia does not have a Bankruptcy Law, but only the Law on Compulsory Settlement, Bankruptcy and Liquidation from 1989, which was enacted during the former SFRY, but has later been thoroughly amended and supplemented to incorporate the idea of reorganization, although in a slightly narrower form compared to the German law. Another characteristic concerns the abandonment of the practice common under the current Law, i.e. conclusion of compulsory arrangement and recovery of the debtor before opening insolvency proceedings. Empiric parameters showed that these attempts are futile and a sheer waste of time. The idea of as short as possible a period between filing the petition for insolvency and opening of the insolvency procedure was adopted instead; insolvency proceedings must be opened in any event, in order for its legal consequences to begin, among which the most important is the termination of authority of the administrative bodies of the debtor and the putting these authorities into the hands of the trustee in insolvency who works under the control of the court. The objective of this measure is to put a debtor, who proved incapable of performing efficiently and profitably, under control immediately in order for the legal consequences of the opening of insolvency proceedings to begin, and only then the court should make an assessment of

whether there are conditions for the recovery of the debtor through the process of reorganization, in cooperation with creditors who are granted a much more active role than under the current law. The third important characteristic of the Draft Law is the introduction of the reorganization of the debtor, with several reorganization methods at disposal. Professor Rakić Vodinelić stressed that our law is not outdated, as it is familiar with the idea of reorganization, which is expressed under the term of rehabilitation (*sanacija*) of a legal entity, an institution especially well developed during self-managed socialism. However, the difference between the two is fundamental because rehabilitation, as regulated by the Bankruptcy Law from the late 1970s, was defined more as a political than as a legal and economic measure, while reorganization is, or at least should be, a purely legal and economic measure. Finally, a significant characteristic of the Draft Law is the changed role of the trustee in terms of his/her wider independence from the bankruptcy court than before.

However, Professor Rakić Vodinelić stressed that although this Draft Law on Insolvency is better than the current Law, it has numerous shortcomings. The first shortcoming concerns the legal consequences of insolvency, in particular those related to employment, since in Professor Rakić Vodinelić's opinion, these provisions were not elaborated sufficiently. Secondly, although the trustee in insolvency is more independent than under the current Law, many provisions stipulate that the trustee must consult the bankruptcy judge, bankruptcy court and creditors' committee, and the question is whether and to what extent such provisions are justified. Professor Rakić Vodinelić sees the following as the major shortcoming: the forms of reorganization of the debtor are only listed, and procedural provisions on reorganization are missing. Each type and method of reorganization must be elaborated in detail in a procedural sense, and the area of reorganization must be much more thoroughly regulated in order to avoid problems that may arise out of the vagueness of the entire area during the practical enforcement of the law. Another shortcoming is related to the absence of provisions on international bankruptcy. In her opinion, the main reason for leaving the provisions on international bankruptcy out of this law is that this is a republican law, which was initially created as a federal law, and as such, it contained provisions regulating international bankruptcy. Professor Rakić Vodinelić concluded that provisions on international bankruptcy are necessary in any case; they should have been formulated in this text, and later it could be decided whether such provisions will be a part of the International Private Law. Incidentally, International Private Law contains only one provision on international bankruptcy, which does not say much, but does cause plenty of problems.

Insolvency Proceedings

Jelisaveta Vasilić, a lawyer, tried to show on a concrete example that the new Insolvency Law can be implemented, i.e. applied in practice, at the same time discussing all its characteristics and describing the entire procedure of bankruptcy, from the insolvency petition to the reorganization process.

Ms. Vasilić noted that when the reasons for bankruptcy occur, a debtor or a creditor files an initial act or petition on bankruptcy. With regard to the perplexities whether there is a bankruptcy with a preliminary proceedings, Ms. Vasilić stressed that the court, precisely on the basis of the petition on bankruptcy, without hearings, makes a decision on whether it is necessary to open preliminary proceedings or not. The court issues a decision on the opening of the preliminary proceedings within three days from the day of receiving the petition. The decision is irrevocable at the outset, without the right of appeal. The previous proceedings lasts 30 days from the day the initial act is received, being followed by the hearings held on the thirtieth day of the opening of the insolvency proceedings, where the conditions for opening the insolvency proceedings are defined.

Ms. Vasilić stressed that the number of cases of bankruptcy with preliminary proceedings is limited. Insolvency without previous proceedings occurs in the following cases: if the debtor files for bankruptcy without necessary documents and papers; if the creditor files a petition and the debtor admits the existence of reasons for insolvency, and if the petition is filed by the creditor who was not paid off during the execution procedure.

Ms. Vasilić also discussed the tasks of the bankruptcy judge and of the insolvency trustee until the examination hearings, with the associated interim deadlines.

After receiving the petition, the judge schedules hearings to discuss the existence of bankruptcy reasons within 10 days from the day of receiving the initial act (in case the court did not rule on preliminary proceedings). At the hearings, the decision is made on the opening of insolvency proceedings, followed by the drafting of a decision and by assigning the trustee, within eight days at the latest (according to Litigation Law). The court releases the announcement on the opening of insolvency proceedings (on the notice board at court and in official journals of the Republic) within about 12 days. The announcement leaves 60 days for the registration of claims and schedules the date of hearings for examining claims (examination hearings) which must be held 60 days from the last day for registration of claims. Hence, if the Law is applied consistently in practice, examination hearings would be held five months after the petition was filed (one month for scheduling and announcing examination hearings, two months for creditors to register their claims and two months for the activities of the trustee).

The duty of the trustee in insolvency, before the examination hearings, is first to make a list of the debtor’s assets, i.e. to appoint a commission to carry this out within ten days from the date of his appointment (and not from the date of him being assigned). Mr. Vasilić stressed that we have examples in practice that the registration of a debtor’s assets and the creation of the initial bankruptcy balance took as long as one year and two months since the opening of insolvency proceedings, which is intolerable. Then the trustee must make an initial insolvency balance with the evaluation of the debtor’s property within 30 days from the day of being assigned to duty; he must create a plan of development, cost and duration of the bankruptcy within 30 days of his appointment, present the report on the economic and financial standing of the debtor with the assessment of the possibility of reorganization, 10 days prior to the examination hearings at the lat-

est, make a list of accepted and opposed claims which is than posted on the notice board at court, 15 days prior to the examination hearings at the latest.
Finally, at the examination hearings, creditors may oppose registered claims of other creditors, i.e. the discussion is held on the list of claims submitted by the trustee and the final list of claims is established. Then follows the discussion on the financial report submitted by the trustee and the assessment of the possibility of reorganization; on that basis creditors whose claims constitute over 70% of the total accepted claims vote for liquidation or reorganization. If they opt for liquidation, it is possible to make a decision immediately on the realization of property, i.e. creditors can agree methods for the realization of assets and on realization terms.
The decision on insolvency can be made in the following ways: on the basis of the decision of creditors at the examination hearings; at the hearings of creditors, which is held 20 days after the examination hearings at latest, i.e. in case when at examination hearings there are not enough creditors whose claims exceed 70% of the total accepted claims; if creditors did not accept reorganization by oral or written voting; and if reorganization fails, the judge issues an order on the continuation of insolvency.
After the end of the examination hearings, which is the major part of the insolvency proceedings as far as the court is concerned, the realization of the insolvent estate begins. The decision on realization is made by the bankruptcy judge at the examination hearings upon the decision made by creditors, i.e. by a bankruptcy judge within 20 days after the examination hearings, if creditors did not accept reorganization. The insolvency trustee or the creditors' committee may raise objections to the decision on realization to the bankruptcy court within the objection term. If the decision on realization follows an unsuccessful reorganization, the trustee in insolvency completely stops business operations of the debtor and begins the realization procedure immediately.
The methods of realization are the following: public bid (with information published about the place and address where property is located, the description of the property and its functional activity, initial price and terms of sale); direct settlement with the collection of bids (with announcement in at least three daily newspapers with high circulation, at least 30 days before the decision is made on the choice of offer) and direct settlement without collecting bids, which must be approved by the creditors' committee.
The procedure of realization is composed of several elements and requires the trustee's obligation to furnish information of intent, of the plan of sale, methods and terms of sale of the debtor to the creditors' committee, of creditors who have secured claims on the property that is to be sold, and of all persons that showed interest in the given property, regardless of the basis of expressed interest, 30 days before the date of the sale, at the latest. A differentiated creditor is entitled to propose more favorable realization of assets or real estate to which he lays a differentiated claim within 10 days from the day of receiving the announcement. Creditors may raise objections to the information 10 days before the sale at the latest. After the sale is carried out, the trustee in insolvency advises the judge and the bankruptcy court and the creditors' committee of the sale completed

within 10 days from the completion of the sale. The trustee settles with the differentiated creditor within 3 days after receiving the price. Through the sale, the property is transferred to the buyer without burdens. The biggest change in the realization procedure is that creditors may raise objections to the sale, but this does not have power to revoke the completed sale, but may only be relevant for indemnification requests. Finally, the sale of a legal entity may be carried out only following the approval of the creditors' committee.

Ms. Vasilić stressed that there are no significant differences between the provisions of the current Law and Draft Law with regard to the main distribution of property. The final list of all claims is known, as well as the amount of every individual claim, the payment order for each claim and the amount of the insolvent estate. The trustee in insolvency should make a draft of the main distribution which must be available to all participants. A proportional part for rejected claims is deducted from distributed assets. Also, if the creditor holds a claim with an abrogative condition, it will be paid only providing that there is collateral. If the creditor holds a claim with a deferred condition, it will be paid a proportional part of the claim, if the condition is effective until the hearings. The distribution of the insolvent estate, i.e. payment of creditors, begins after the decision on the main distribution of property, released by the bankruptcy court, becomes irrevocable.

Finally, the bankruptcy court holds a final hearings with the following agenda: discussion on the final financial statement of the trustee, final request for payment of award and costs of the trustee, possible objections to the final financial statement, decision making on undistributed assets and on the closing of the insolvency proceedings.

Ms. Vasilić stressed that according to the new Draft Law the entire insolvency procedure previously described should last 5 – 6 months from the moment of the filing of the initial act to the examination hearings. Under the current Insolvency Law, court practice records insolvency cases that last ten years, which is neither useful for creditors and debtors, nor for society as a whole. Only a fast and efficient insolvency is good for creditors, debtors and for society as a whole.

Ms. Vasilić stressed that this Draft Law was created in cooperation and with active participation of foreign experts and therefore is not fully in line either with the continental or with the Anglo-Saxon model, but is a mixture of the two.

The process of reorganization begins with the submission of a reorganization plan. The reorganization plan can be submitted by: the debtor, the trustee in insolvency, creditors which have at least 30% of secured claims, creditors which have at least 30% of unsecured claims, owners of at least 30% of the debtor's capital in the form of shares, or similar. The reorganization plan must be submitted in written form.

As far as the terms for submitting the reorganization plan are concerned, Ms. Vasilić stressed that the biggest objection, among the many that can be directed at this Draft Law, relates to the provision that creditors' hearings are held 30 days after the date of the filing of the petition for bankruptcy. Claims must be identified before the reorganization; only those claims which are confirmed at examination hearings are considered confirmed claims. That is why this provision is hardly applicable in practice. To put right this shortcoming, in terms of submitting the

reorganization plan, it is established that the reorganization plan should be submitted to the bankruptcy judge for approval 90 days from the date of the opening of insolvency proceedings at the latest (which is an achievable term), whereby the court, under certain circumstances, may prolong this term for additional 30 days. Any further prolongation of the term for over 120 days is possible only following unanimous approval of secured creditors. The reorganization plan can be submitted simultaneously with the filing for insolvency, if all other conditions prescribed by this law are fulfilled, but this plan cannot be subjected to voting.

A reorganization plan must contain: a brief introduction into the line of business of the debtor and on circumstances that led to financial difficulties; the reorganization method (21 methods of reorganization proposed in the Draft), funds for the realization of the plan and the method of reorganization; the amount of the debt and the value of assets that will be distributed among creditors for full or partial payment of the debt; terms for the implementation of the plan; the list of members of managing bodies; the list of experts who will be engaged in the reorganization; comparative data on success in five years of reorganization and the estimation what will be achieved through the liquidation of the debtor; the date as of which the plan comes into effect; and finally, the contents of the plan should imply that the reorganization will yield results.

Voting and adoption of the reorganization plan is carried out as follows: all creditors with confirmed claims are entitled to vote (that is why creditors' hearings cannot be held 30 days from the date of the filing the petition). Voting is performed in written form (*in absentia*) or orally (at the hearings). With written voting, each voting list must be endorsed by a legal entity (for legal entities), or by court or by another competent office (for natural persons and subjects which do not have the status of a legal entity). Creditors' claims are divided into classes according to priority (the court can approve special classes to be introduced for administrative reasons, e.g. too many small claims). Before voting, the court informs participants about the results of written voting. Voting is performed per classes of creditors, and the plan is considered adopted if it was approved by the creditors which possess the major portion of claims in their class. The class of creditors whose claims are fully paid according to plan is considered as having accepted the plan, and that class is not obliged to vote. The plan is adopted following the acceptance of all classes of creditors.

The adopted reorganization plan has the following effects: debtor-creditor relations are regulated pursuant to the conditions defined in the plan; the plan has the power of an executive document; all activities of the debtor must comply with the plan; the trustee supervises the implementation of the plan; the trustee advises the court and creditors on the violation of the plan; the label "bankrupt" is erased from the register; if the debtor violates the plan, every creditor has the right to inform the court of that circumstance; the court makes a decision on measures and gives orders for the implementation of the plan; the court may issue the order on the continuation of insolvency proceedings (if the debtor is not the one who implements the plan, the decision on whether some new measures for the implementation of the plan will be introduced and whether the insolvency proceedings will continue rests with the court).

In conclusion, Ms. Vasilić discussed the case of insolvency out of reorganization. This is possible in the following cases: if no reorganization plan is accepted; if the debtor does not act in compliance with the plan; if the debtor does not cooperate with the trustee or the creditors' committee (which remains during the reorganization, supervising the implementation of the reorganization process and cooperation with the trustee in insolvency); if the debtor does not fulfill measures and orders of the bankruptcy judge which are issued in accordance with the plan, and when the debtor in reorganization itself asks for insolvency (and there is no alternative plan).

Characteristic Differences Between the Current Law on Compulsory Settlement, Bankruptcy and Liquidation and the Text of the Future Law

Mihajlo Rulić, judge and Deputy President of the High Commercial Court in Belgrade discussed characteristic differences between the current Law on Compulsory Settlement, Bankruptcy and Liquidation and the text of the future Insolvency Law (the February 2003 version).

Mr. Rulić stressed that the titles of the current and the future laws clearly indicate the difference between the areas they regulate. The current Law, under Article 1 stipulates that the Law regulates the conditions for pursuing proceedings of compulsory settlement, bankruptcy and liquidation. The new Draft Law regulates the process of insolvency and reorganization of the debtor. This means that compulsory settlement will not be the only method of "reorganization".

The current Law foresees uniform bankruptcy proceedings regardless of the value of the assets of the debtor, and regardless of the amount of its liabilities. The new Law introduces the institution of small value proceedings, for cases when the debtor's assets are lower than YuD 5 million, although it is still uncertain who is responsible for the evaluation of the debtor's assets and when, and what determines the type of proceedings.

Both the current Law (art. 2) and the new Law (art. 3) foresee illiquidity of the debtor as reason for insolvency or reorganization.

The new Law introduces a new body: the creditors' committee. This committee makes decisions on whether the proceedings will be pursued as so called classical insolvency or the trustee will continue to work, aiming at reorganization of the enterprise. Regardless of what solution the committee opts for, whereby its decision is binding for the court, the committee elects a creditors' board which acts as an operational body, giving opinion and in some cases giving approval to certain acts of the trustee.

A significant difference between the current Law (art. 69) and the new one (art. 26) is that according to the current Law the opinion of the creditors' board only has an advisory character, while the new Law foresees, besides an advisory role, mandatory approval by the creditors' board for certain acts of other insolvency bodies.

The new Draft Law also introduces stricter criteria for appointment of the trustee, which should result in more efficient administration of insolvency proceedings. In Mr. Rulić's opinion, the solution according to which the Agency will have the role

of a trustee in insolvency proceedings in legal entities which are predominantly socially-owned or state-owned should be understood as temporary, because the new Law should continue regulating this area after the end of the privatization process.

According to the current Law, insolvency proceedings are carried out over a legal entity (art.4), while, under the new Law, both legal entities and natural persons that operate a business (entrepreneur) may appear as debtors. This is an important difference between the current and the new law, since an entrepreneur is responsible for his obligations to the creditors with his personal property according to the Law which regulates organization, operation and liability of entrepreneurs.

According to the current Law (art. 3), insolvency proceedings may be opened by creditors, by the debtor and by other persons, i.e. officials defined by the Law. With regard to many years of court practice, insolvency proceedings have been mainly opened by the office in charge of payment operations of the debtor. On the other hand, a creditor could file for insolvency of the debtor only providing his previous futile attempts to settle the claims with the debtor through mandatory settlement proceedings. Both the current and the future Laws foresee the possibility that the debtor him/herself will file for bankruptcy. Again, cases of debtors who file for insolvency are not frequent in court practice (about 1% of all insolvencies filed since the adoption of the current Law in 1989 up to now).

Both texts contain the institution of debt assumption; both texts also establish preliminary proceedings as a kind of litmus test which the file must pass before insolvency proceedings against the debtor are initiated. An important novelty is that the new Law stipulates that the previous insolvency proceedings cannot last longer than 30 days from the date of the filing of the petition of insolvency. This is a very short term, as Mr. Rulić stressed, bearing in mind the organization of courts, but it is certainly necessary to make a decision on the petition in the shortest possible period.

According to article 93 of the current Law, with the day the insolvency proceedings are opened, workers employed at the debtor's are terminated. This is an imperative provision. The new Law foresees the termination of employment as a possibility and not as an imperative.

According to article 102 of the current Law, interest on claims of the debtor which should be paid from the insolvent estate does not cease to be effective from the day of the opening of the insolvency proceedings. This is a default interest. This legal provision was aimed at accelerating insolvency proceedings, but it did not yield expected results and hence the new Law in its article 68 stipulates that contracted interest stops to be effective from the date of the filing of the petition for insolvency.

The new Draft Law also introduces some novelties in the course of proceedings with an apparent aim to accelerate it.

It also introduces the institution of an arbitrage committee under the expert governance of the bankruptcy judge (the bankruptcy judge is an individual arbiter or the president of an arbitration committee).

The current Law does not contain provisions that regulate the treatment of additionally found assets, while the new Law in article 125 foresees distribution after the conclusion of insolvency proceedings on the basis of additionally found assets.
The entire third part of the new Draft Law that regulates reorganization is a novelty, and therefore the question of efficiency of the projected reorganization methods will be answered by court practice in the future, Mr. Rulić concluded.

Economic Aspects of Insolvency

Ljubomir Madžar, from BK University, Belgrade, discussed the economic aspects of insolvency. Professor Madžar sees the new Law as a step in the right direction toward more complete protection of creditors than is the case today. Overprotection of debtors and near absence of the protection of creditors are joint characteristics of all socialist societies, and the contract was not the contract in the full sense of the word, the obligation was not a real obligation, and financial discipline did not exits. Hence, this Law is a step toward stricter market discipline, which is absolutely necessary, because otherwise market instruments cannot function.
Professor Madžar stressed that it is necessary to examine all possible implications of this Law with regard to the reorganization of our courts and other institutions that should perform duties and functions assigned to them by this Law. The question is whether our courts are ready to carry out everything stipulated by this Law, and if they are not, how to revise these oversights in order to achieve a mechanism that will impose financial discipline and ensure that the economy, at least in this area, operates as a real market economy.
Professor Madžar approves the acceptance of the philosophy of Chapter XI of the US Bankruptcy Reform Act which says that the reasons for opening insolvency proceedings are not automatically the reason for closing down a company, since liquidation of an organization is expensive. By closing down a company that is not able to pay its debts, that company will stop producing losses, but at the same time, it will lose a large part of the added value that was generated, along with many jobs. There are insolvencies which mean only the transfer of assets from one use to another, whereby added value, i.e. social product, is not lost. However, the majority of insolvencies are not of that type, and it may occur that the loss of added value and of jobs costs society more than the eliminated expenditures. It is therefore good to have a mechanism that gives organizations the opportunity to restructure, i.e. reorganize their work and stay in business. The mechanism in itself contains a certain contradiction which may result in so-called “moral hazard”. Therefore, strict rules must be established to ensure market discipline, i.e. enterprises which do not work well must go bankrupt. However, the application of these rules to individual cases, which is aimed at saving a portion of economic value, may turn out to be too expensive, and hence there is a tendency of avoiding the strictest measures. In this way other businesspeople get

the message that they could also go without punishment. In professor Madžar's opinion, special attention must be paid to this problem.
As far as the trustee in bankruptcy is concerned, Professor Madžar objects to the provision which stipulates that the trustee is not accountable primarily and only to the creditors' committee, but to the court. In his opinion, solutions from other legislations should be examined in that respect. The bankrupt organization is to blame for its state of affairs and therefore the creditors' committee should have all power and control over it, and the trustee should be accountable to the creditors' committee, while the court should take care of proper enforcement of the law.
Speaking of reasons for opening insolvency proceedings, professor Madžar pointed out that it is still unclear whether insolvency proceedings are opened when the company is insolvent or illiquid, i.e. there is lack of compliance between legal and economic terminology (in economic terms, an enterprise need not be insolvent to be illiquid, and in that case it would go bankrupt). He therefore suggested that all terms which are used in bankruptcy legislation, as one specialized area, should be collected in one place, as was done with some other laws.
In conclusion, Professor Madžar pointed out that bankruptcy legislation is a great opportunity for privatization. In his opinion, the privatization process should be carried out more in the form of conversion of credits, loans and debts into shares in ownership. This method would accelerate the privatization process and the sale of unattractive and heavily indebted enterprises. Since the opportunity for making this privatization method more relevant was missed during the creation of the Privatization Law, the Insolvency Law may serve as an opportunity for revision. It is necessary to examine the possibility of combining this method of privatization with insolvency proceedings, since this would result in a double benefit, Professor Madžar concluded.

The Most Important Practical Questions In Relation to the Enforcement of the Insolvency Law

Vesna Rakić – Vodinelić drew attention to some other provisions of the Insolvency Law which must not be maintained as they are currently defined in the Draft. Firstly, a provision from article 32 stipulates that the Federal Republic of Yugoslavia cannot appear as a debtor in insolvency. In Professor Rakić Vodinelić's opinion, the proposer must decide whether this is a federal law (which, as a matter of fact, cannot be passed any longer) or a law on the level of the Republic, and, depending on that choice, erase all unnecessary provisions from this article. As far as the scope of work of the trustee in insolvency is concerned, Professor Rakić Vodinelić especially criticized point 15 of article 16, which regulates the trustee's scope of work with regard to the debtor in a foreign country. Since this Law does not regulate bankruptcy with an international element, it should not contain this provision. The strongest message Professor Rakić Vodinelić wanted to send is that article 131 should not remain as formulated in the Draft Law, since in the way it is proposed, this provision is in opposi-

tion with other provisions of the Law owing to inadequate systematization (22 offered methods of reorganization can be systematized in 4-5 methods) and because it is not elaborated sufficiently. Moreover, Professor Rakić Vodinelić pointed to the inadequacy of the used terminology, which in part resulted from translation (bankruptcy and insolvency mean the same, while bankruptcy was used instead of liquidation, etc.). Again, she raised the question of international bankruptcy, which should be regulated. As far as reorganization is concerned, Professor Rakić Vodinelić raised the question of timeframes in insolvency proceedings. Shorter timeframes for insolvency proceedings are desirable because they will make the entire proceeding shorter, although they also increase the cost of the proceedings. Again, there is a question of overstepping timeframes, because all parties in the proceedings mostly do not lose their rights as a result of not respecting timeframes, and very rarely the judge and trustee in insolvency may be subjected to sanctions. Therefore it is necessary to find a balance between shortening timeframes and reducing the costs of proceedings, or to introduce the possibility of denial of certain procedural authorizations instead of shortening terms, if certain actions are not undertaken in due time, which is a much more serious sanction that would guarantee the respect of terms, especially those related to the actions on the part of creditors. In conclusion, Professor Rakić Vodinelić wondered whether the most common creditors in our country (workers, public utility companies, the state) can be expected to be active and diligent in insolvency proceedings, as can be expected from private or commercial creditors; she therefore suggested that the entire procedure of insolvency proceedings should be regulated according to the answer to this question.

Jasmina Zjalić, judge at the Commercial Court in Novi Sad, discussed the (im)possibility of enforcement of the new Insolvency Law from an operational, i.e. practical perspective.

Ms. Zjalić categorically and clearly stated that from a practical perspective the Insolvency Law designed as it is, with all the terms and guidelines it contains, is too narrow and overly standardized, thus becoming practically unenforceable, and for these reasons, application of such a Law would be too expensive.

With regard to proceedings in two instances, bearing in mind that each party has the right of appeal, it will be impossible to process insolvency proceedings while respecting the prescribed terms.

Ms. Zjalić further stressed that we do not have human resources capable of enforcing this Law within the prescribed terms. Many questions are still unresolved in relation to the trustees in bankruptcy (e.g. their certification). This Law increases the responsibilities of the trustee, but on the other hand, he/she is not provided with the legal background that would guarantee successful work (execution procedure, new Litigation Law and in a certain way statutory obligation of financial discipline of the debtor before the insolvency proceedings). Such a situation can only turn away capable and quality human resources and open room for speculators.

This Law signifies a dramatic shift as compared to the previous one, and, bearing in mind typical creditors in our economy (workers, public utility companies, the

state), and without ensured financial discipline and control that precedes the insolvency proceedings, it could only turn away and discourage foreign investors.
Bearing in mind everything previously advanced, Ms. Zjalic suggested that the old Law should be modified first as a provisional solution, primarily with the aim to make creditors' rights more clear, waiting for other necessary regulations to be adopted, and only then to take this issue into serious consideration.

Zoran Branovački, adviser with the Committee for an Economic Legal System of the Chamber of Commerce of Serbia first stressed that the Draft Law on Insolvency attracted great attention among businesspeople. Not intending to appear as a critic, Mr. Branovački pointed to objections expressed by regional chambers, which are more intended to serve as guidelines for improving the draft.
Mr. Branovački stressed that, in spite of enormous interest among businesspeople for this Law, there are not many objections and proposals form their side. Businesspeople still do not believe that they can contribute with their proposals, but are waiting to see what the state will do, and only than will take a certain position. Therefore, presentations, public speeches, visits to regional centers are positive steps towards the change in business people's attitude in the way that they can also contribute to the improvement of the concrete legislative text with their observations and experience.
Businesspeople stress the following features of the Draft Law as positive: putting the interest of creditors into the center of the insolvency proceedings, setting up a creditors' committee, giving wider authority to the creditors' board, higher efficiency of insolvency proceedings ensured through a simpler procedure and shorter terms, the introduction of bankruptcy of natural persons, the affirmation of the institution of arbitrage and the introduction of the process of reorganization as a completely new solution.
Advocating the interests of businesspeople, i.e. members of regional chambers, Mr. Branovački gave several concrete objections to the text of the Insolvency Law.
Firstly, with regard to mandatory appointment of the Agency that will act as a trustee in the insolvency of legal entities in state or social ownership, big socially-owned and state-owned companies, businesspeople do not understand why it is necessary to make a difference between the legal regimen between them and legal entities in private ownership. The consequent proposal is to explain the necessity for appointing this Agency. Article 24 of the Draft Law which refers to the power of the creditors' board to dismiss its member is also unclear and requires explanation, since it is a legal precedent that a body which does not elect its members is allowed to dismiss them (the creditors' committee is responsible for electing members of the creditors' board). Also, the legislator's intention not to give equal order of payment to claims on the basis of taxes and contributions and claims of other creditors, i.e. to give priority to claims on the basis of taxes and contributions over other claims is an outdated form of putting the state in a more favorable position over other creditors. Furthermore, the Draft Law does not contain the solution which provides for the creditor who holds over 25% of total claims to be entitled to mandatory membership in the creditors' board. Business-

people believe that the absence of this solution holds the risk of creating a majority among a large number of small creditors in relation to the biggest creditor, and of influencing the creditors' board. In terms of certification of trustees and the solution to set up a special certification agency, the question is if this solution is justified in the long run (business schools for education already exist within chambers of commerce). Under the new law, the trustee is granted greater operative powers and greater responsibility, which is justified. However, certain provisions that regulate the responsibility of the trustee are too widely defined and should be put forth more precisely (e.g. the bankruptcy court can dismiss the trustee if he does not make satisfactory progress in the realization of assets, except if this is the result of a *force majeur* or unpredictable circumstances). Also, the enforcement of this law will require harmonization with other laws and regulations. For example, the new Insolvency Law and the current Law on Payment Operations will be in collision as the National Bank of Serbia is left out of the list of subjects entitled to initiate the insolvency proceedings. Another objection, i.e. proposal, refers to possible introduction of more flexible terms for undertaking actions in insolvency proceedings, depending on whether the debtor belongs to the category of small, medium or big enterprises, i.e. classification criteria prescribed under the Accounting and Auditing Law should be applied to the flexibility of terms under the Insolvency Law. Furthermore, businesspeople wonder whether the abolition of interests on creditors' claims after the initiation of insolvency proceedings is justified. There are also questions related to the differentiation between current and durable solvency of a debtor: what will be the practical consequences of application of the provisions on insolvency and how the procedure of establishment and proving whether it concerns current or durable insolvency will look like. Finally, there are some objections regarding the reorganization process, which certainly attracted the greatest interest. Firstly, there is an opinion that decision making on the reorganization plan is very complicated as decisions are made by classes of creditors (the possibility of halting the approval of the reorganization plan by one class). Secondly, article 142 is not clear, and contains one oversight (with regard to the implementation of the reorganization plan). This article does not put forth clearly what body is in charge of establishing the reorganization plan and by what act this is done; hence, practical enforcement of this provision is questionable, Mr. Branovački concluded.

Vesna Ilić, president of the Commercial Court in Kragujevac, speaking from the perspective of extremely negative experiences with creditors in practice, stressed that creditors are granted too much authority. Insolvency is aimed at protecting and settling of creditors, but not to an extent which leaves room for abuse. In her opinion, a solution by which the creditors' board is entitled to give opinions and approvals is not good; it would be much better for it to have only an advisory, and not a binding character.
Vesna Rakić Vodinelić, however, said that in general she does not agree with the approach to use bad experiences with creditors and their negligence as argumentation to deprive them of the role they are entitled to in normal insolvency legislation, that is, to have a certain degree of control over insolvency.

Mihajlo Rulić explained that bad experiences with creditors in practice are the result of the still present syndrome of self management, where workers at the same time appear as creditors who, depending on their interest in the insolvency proceedings, act as it suits them, and such insolvency files currently cause most troubles for judges.

Olivera Trikić, Director of the Department for Bankruptcy and Liquidation of Banks of the Agency for Deposit Insurance, Rehabilitation, Bankruptcy and Liquidation of Banks spoke about the impossibility of responding to terms prescribed under the new Insolvency Law. To respond to the 10 day term for making the list is an illusion, and the experience of banks in bankruptcy shows that even the 60 day terms is too short, due to the unavailability of all information. The 60 day term for registration of claims is hard to fulfill as well, because there are large numbers of registrations of claims, inaccurate data, lack of cooperation by workers who stayed in their jobs, etc. With regard to the sale of property, it is impossible to start the sale of property if banks (both bankrupt and active) and enterprises do not have proof of ownership. The sale of real estate is also difficult due to the fact that the sale of property requires evaluation and public advertisement of the evaluation, which only increases the cost of the procedure, Ms. Trikić concluded.

CONCLUSION

It is obvious that the New Draft Law on Insolvency attracted great interest among all participants at the roundtable, with notable perplexities and ambiguities both among theorist and practitioners, including the author of this text, regarding how certain provisions and novelties introduced by this Law will be efficiently applied in practice.

It seems that the common position of all participants is that although the new Insolvency Law may be seen as a positive step in the right direction, some of its solutions need to be more precise and supplemented precisely for the sake of its efficient application, while practical application must be followed by the establishment of financial discipline of the debtors prior to the insolvency proceedings and by amendments to other related laws and regulations.

By organizing this meeting, the G 17 Institute wished to ensure continuation of the already initiated public debate on new insolvency legislation, with special emphasis on the assessment of economic and legal effects of the solutions foreseen in the Draft Law, and to offer answers to questions as to how to regulate efficiently this area which is of great importance for the continuation of the process of reforms.

Miroslav Zdravković

Economic Development as a Result of a Deliberate Policy of Attracting Export-Oriented Foreign Direct Investments - the Experience of Ireland as a Lesson for Serbia

The inflow of foreign direct investments (FDI) has a complex impact (positive for the most part) on the economic development of countries where investments are made. The intensity of the impact and long-term consequences depend solely on the ability of one country to make the best possible use of positive effects, while neutralizing negative ones. The ability of one country depends on the qualification level of the workforce, as well as on the active policy of developing those qualifications in order to keep the largest possible portion of value added branches, and to attract new FDIs.

This article will discuss the basic indicators of Ireland. This country managed to achieve an impressive acceleration of GDP growth from 2.7% on average per year during the 1980s to 7.3% during the 1990s, owing to the inflow of FDIs in export-oriented programs of high technologies which record the highest growth rates in international trade in goods and services. We have chosen the example of Ireland, because of certain similarities between this country and Serbia, while experiences from neighboring countries (Hungary) are not that useful because they lack a deliberate development strategy. Hungary has opened its economy completely to the inflow of FDIs, thus stimulating industrial restructuring and recovery of export-based production[17], but it is highly dependant on future trends in relative competitivity indicators (in particular the price of labor) because it has not developed and advanced qualifications of the domestic workforce. Further moving of work-intensive processes away to the East (Ukraine, Romania, Bulgaria…) is underway as the price of the Hungarian labor force is expected to increase after this country joins the EU.

The major similarities between Serbia and Ireland are the following: (1) relatively small countries (population in Ireland - 3.6 million, and in Serbia - 7.5 million); (2) good geographical location (Ireland between the Anglo-Saxon and continental countries, and Serbia between Western Europe and the Near East); (3) political problems resulting from ethnic divisions (Northern Ireland, Kosovo, B&H); and (4) a vast Diaspora. The key advantage of Ireland in comparison to Serbia is that it is an English-speaking country and an EU member.

The key difference between the two countries is that the Irish are relatively humble regarding their nation, which results in their clear determination to strengthen their economy in order to be able to resolve ethnic problems more easily. Both heavenly and earthly Greater Serbias are still present in the minds of about one

[17] Hungarian exports increased from US$ 12.8 billion in 1995 to US$ 25 billion in 2000, whereby foreign branches increased their value of exports from US$ 7.5 to US$ 20 billion, indicating that the remaining exports were in stagnation.

third of the adult, poorly educated and financially vulnerable population, which constitutes a breeding ground for chauvinistic ideas (covering up the interests of the few), and limits chances for internationalization of our national economy.
We will therefore discuss the positive experiences of this country in order to search for the developmental paradigm for Serbia, a country lost between the need to reform the economy and society very quickly, and accumulated national problems and frustrations.

Success in Exports as a Result of Specialization in the Fastest-Growing Sectors of World Trade

The specialization of a national economy should be reflected in comparative advantages. The degree of specialization should be subject to the level of economic development. For example, economically underdeveloped countries are highly dependant on the export of one or several primary products (crude oil, citrus fruits, wood, etc.), while developed countries diversify their export supply through production and trade of industrial products (intra-industrial exchange). Serbia is, unfortunately, an absurd example: it reports among the world's lowest levels of specialization (after Italy and Austria), with a symbolic export value. On the other hand, Ireland, during the period of strong exports growth, improved its specialization level, focusing on a small group of products: the three largest groups of products, according to the export value, constituted 49.9% of the total commodity exports (this share in Serbia amounted to 14.1% in 2002) in 2001. The Hirchmann index of export concentration rose from 0.205 in 1997 to 0.286 in 2001, when the value of commodity exports increased from US$ 53.6 to US$ 82.8 billion. Such impressive exports growth actually resulted from specialization in the fastest growing sectors of world trade.

Table: The First 15 Groups of Products of Three-Digit SITC in the Irish Exports In 2001

Rank	Name of the groups of products	Exports value in 2001 in US$ thousands	Share in the total exports of Ireland in %	Average annual growth rate of world exports, 1997-2000, in %
1	Organo – Inorganic Compounds	14,046,215	20.38	12.3
2	Automatic Data Processing Machines And Units Thereof	10,098,998	14.65	4.7
3	Parts And Accessories Suitable For Use Solely Or Principally With Office Machines Or Automatic Data Processing Machines	9,887,010	14.35	12.5
4	Medicaments	6,711,939	9.74	11.1
5	Thermionic Electronic Tubes	5,573,987	8.09	12.9
6	Special Transactions And Commodities Not Classified According To Kind	3,308,476	4.80	5.3
7	Telecommunications Equipment	3,115,871	4.52	15.4
8	Musical Instruments	3,113,666	4.52	0.6
9	Essential Oils, Perfume And Flavor Materials	2,212,556	3.21	3.5
10	Miscellaneous Chemical Products, N.e.s.	1,754,134	2.55	4.3
11	Medical Instruments	1,377,409	2.00	5.4

12	Miscellaneous Manufactured Articles, N.e.s.	1,303,775	1.89	6.2
13	Medicinal And Pharmaceutical Products, Other Than Medicaments	1,295,981	1.88	4.6
14	Edible Products And Preparations, N.e.s.	1,287,717	1.87	0.5
15	Electrical Apparatus For Switching Or Protecting Electrical Circuits Or For Making Connections To Or In Electrical Circuits	1,100,043	1.60	8.0
Total 1-15		**66,187,777**	**78.45**	**9.1**
Other 248 groups of products		**16,778,981**	**21.55**	

The Table shows that 15 groups of Ireland's exporting products registered an average annual growth rate of 9.1% in the world market, while among the seven most important ones, five belonged to the fastest growing sectors in world trade, with double-digit growth rates.
The following Table shows basic information on winning competitive positions, traditional exports which are in stagnation on the markets won, and loss of competitiveness of the Irish economy in the period 1997 – 2001.

Table: Export Trends in Selected Groups of Products, Ireland, 1997-2001

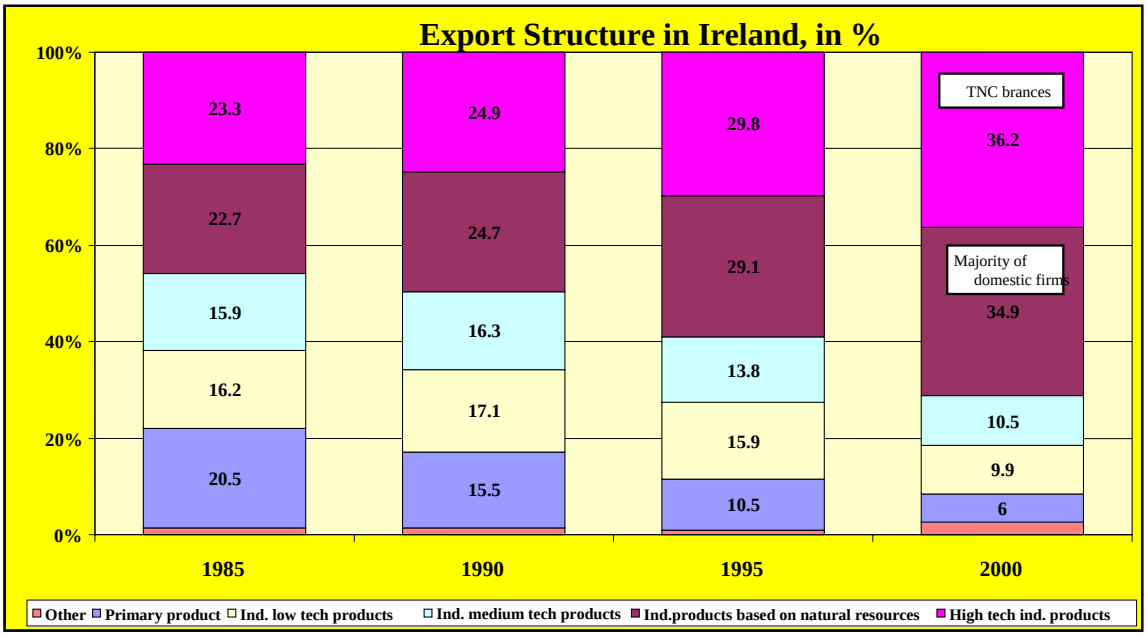
The fastest growing exports (over US$ 30 million in 2001), in US$K							Average annual growth rate, Irish exports, in %	Average annual growth rates, total world exports, in %
Code SITC		1997	1998	1999	2000	2001		
899	Misc. Manufactured Articles, N.e.s.	23,059	245,096	450,974	760,250	1,303,775	53.8	6.1
781	Motor vehicles	82,538	205,962	251,029	287,620	371,759	45.7	4.9
515	Organo-inorganic compounds	5,144,512	10,126,952	10,309,827	14,210,764	14,0462,15	28.5	12.3
776	Thermionic Electronic Tubes	2,160,542	2,283,921	2,821,231	4,167,047	5,573,987	26.7	12.9
542	Medicaments	2,606,894	3,811,166	3,896,703	3,726,936	6,711,939	26.7	11.1
764	Telecommunication Equipment	1,348,943	1,892,946	3,679,776	3,179,196	3,115,871	23.3	15..3
759	Parts and Accessories for Office or ADT Machines	4,429,236	5,551,362	6,434,301	8,119,640	9,887,010	22.2	12..5
541	Medicinal and Pharm. Products, Other Than Medicaments	749,791	934,688	1,252,470	1,181,433	1,295,981	14.7	4.5
551	Essential Oils, Perfume and Flavor Materials	1,420,270	1,693,712	1,952,608	1,598,626	2,212,556	11.7	3.5
598	Miscellaneous Chemical Products, N.e.s	1,141,763	1,253,189	1,673,920	1,432,291	1,754,134	11.3	4..3
	TOTAL	19,317,548	27,998.994	32,695,839	38,663,803	46,273,227	24.4	

Traditional exports (selected groups of products), in KUS$							Average annual growth rate, Irish exports, in %	Average annual growth rates, total world exports, in %
Code SITC		1997	1998	1999	2000	2001		
017	Meat, Prepared Or Preserved N.e.s.	219,533	219,955	233,025	247,253	297,697	7.9	-4.5
034	Fish, Fresh or Frozen	208,616	197,111	173,533	178,023	238,349	3.4	1.7
054	Vegetables, Fresh, Chilled, Frozen or Simply Preserved	101,220	105,672	98,466	86,509	115,495	3.4	0.7
098	Edible Products and Preparations, N.e.s.	1,142,887	1,196,465	1,259,397	1,208,468	1,287,717	3.0	0.5
024	Cheese and Curd	313,663	309,435	290,863	265,406	345,788	2.5	-2.3
012	Meat Other Than of Bovine Animals, and Edible Offal	492,223	443,865	489,736	485,860	526,717	1.7	-2.8
073	Chocolate	188,487	196,012	200,384	201,060	197,108	1.1	-3.6
081	Feeding Stuff for Animals (not Including Unmilled Cereals)	115,465	115,948	121,085	111,643	119,808	0.9	-6.2
112	Alcoholic Beverages	712,965	694,170	723,781	717,179	700,189	-0.5	-0.3
898	Musical Instruments	3,530,095	3,663,899	4,181,828	4,022,668	3,113,666	-3.1	0.6
	TOTAL	7,025,154	7,142,532	7,772,098	7,524,069	6,942,534	-0.3	

Loss of export competitiveness (selected groups of products), in KUS$							Average annual growth rate, Irish exports, in %	Average annual growth rates, total world exports, in %
Code SITC		1997	1998	1999	2000	2001		
792	Aircraft and Equipment	237,725	347,403	301,655	260,771	201,144	-4.1	5.8
821	Furniture and Parts Thereof	139,252	140,091	113,759	97,181	100,476	-7.8	6.7
011	Meat of Bovine Animals, Fresh, Chilled or Frozen	886,012	930,324	1,142,634	875,904	589,818	-9.7	1.6
023	Butter and Other Fats and Oils Derived From Milk	478,689	481,791	384,572	321,183	294,594	-11.4	-8.3
894	Baby Carriages, Toys, Games and Sporting Goods	222,974	198,659	158,554	127,347	133,927	-12.0	2.0
061	Sugars, Molasses and Honey	79,930	51,733	55,944	43,094	47,944	-12.0	-11.4
842	Female Coats, Capes, Etc.	101,040	91,719	81,789	65,354	55,421	-13.9	2.2
841	Men's Coats, Jackets, Etc.	73,080	63,026	53,961	38,313	32,021	-18.6	-0.2
845	Articles of Apparel, N.e.s.	193,930	201,672	136,843	96,038	77,969	-20.4	4.1
895	Office and Stationery Supplies, N.e.s.	145,163	110,776	77,891	56,483	34,705	-30.1	3.1
	TOTAL	2,557,804	2,617,194	2,507,612	1,981,668	1,568,019	-11.5	

In the Table showing exports trends in the selected groups of products it can be seen that the fastest growing portion of exports fully explains the total increase in exports. Namely, while in the period under consideration Irish exports grew from US$ 53.6 to 83 billion (an increase of US$ 29.4 billion), the 15 fastest-growing groups of products increased their export value by US$ 27 billion. This means that the remaining portion of exports was in stagnation or went into decline. The

Table also shows that traditional export commodities stagnated, while work-intensive products were rapidly disappearing from the exports supply.
The Chart of structural changes in the exports of Ireland shows how dynamic the period from the mid-80s was, when the inflow of FDIs suddenly increased. Already in 1985 the portion of high technology products was rather large, but the structure of exports was diversified. The total export value could be increased only through specialization, which involved the winning over of certain segments and the subjection of the majority of sectors to the market, which for the most part resulted in their disappearance from export supply and stagnation or drop of industrial output. Primary products nearly completely vanished from export supply (although they increased their absolute value), thus reducing their share in total exports from 20.5% in 1985 to 6% in 2000. Industrial products of low and medium technologies also lost their relevance: from 32.1% to 20.4% respectively. TNC branches concentrated on high technologies (rise in the share in total exports from 23.3% in 1985 to 36.2% in 2000), while domestic companies focused on industrial products based on natural resources. Domestic companies managed to restructure successfully from primary products to primary products-based industrial products (e.g. from agricultural to food products), thus increasing profitability of production and exports. TNCs left the sectors in which Ireland lost competitiveness of a cheap workforce and made use of the newly established advantage of highly qualified labor and good treatment of foreign investors.



The Role of Transnational Companies in the Exports of Ireland

Concrete companies stand behind the data of Standard International Trade Classification on export values according to groups of products. Among one hundred greatest exporters in Ireland, two-thirds are TNC branches. The following Table lists 15 biggest branches according to the export value realized.

Table: 15 Biggest Foreign Branches in Ireland According To the Export Value Realized In 1998

Mother company	Industry	Value in US$ million	% of Irish exports
Intel	Electronics	4,804	6.4
Dell Computer	Electronics	4,313	5.8
Microsoft	Computer-related services	2,380	3.2
Johnson & Johnson	Pharmaceutical	1,337	1.8
Bristol-Mayers Squibb	Pharmaceutical	1,026	1.4
Gateway	Electronics	967	1.3
Apple Computer	Electronics	892	1.2
EMC	Electronics	744	1.0
3 Com	Electronics	684	0.9
Motorola	Electronics	506	0.7
IBM	Computer-related services	409	0.5
Ingersoll-Rend	Electronics	294	0.4
Baxter International	Medicinal instruments	265	0.4
Allergan	Pharmaceutical	253	0.3
Lilly, Eli and Company	Pharmaceutical	245	0.3
Total		19,119	25.6
Total Foreign Branches (major ownership of TNC)		45,804	61.2
Total Irish Exports		74,878	100.0

The Table shows that the companies operated in the area of electronics (8), the pharmaceutical industry (4), computer-related services (2) and medicinal instruments (1). An important effect in the selection of location, i.e. Ireland in this case, is clusterization – concentration of the same or similar production processes in a relatively small geographical area. Of the 55 biggest branches according to the export value, as many as 9 operated in the production of medicinal instruments, of which 7 were from the USA, one from Germany and one from Austria. **The entry of the first branch from the USA and its business success encouraged other companies to come, first from the USA and then from Europe (Bayer) in order to make use of technological externalities.** A similar situation occurred in the pharmaceutical industry (12 companies – 7 from the USA, 1 from Japan, 4 from Western Europe) and electronics (22 companies – 16 from the USA, and 6 from Japan and Western Europe).

The Policy of Attracting FDIs

A government's policy in attracting FDIs should take into account the current state of affairs and trends in the world economy and comparative advantages of

a national economy. In the early 60s Ireland set up the Investment and Development Agency (IDA) and practiced a very liberal and non-selective approach to attracting FDIs. Market access to the then EEC was, besides favorable geographical location and English language, sufficient to attract TNCs from the USA. The effect of clusterization attracted other US TNCs and their competition from Canada, Japan, Australia and Western Europe to follow those who started their business in Ireland first.

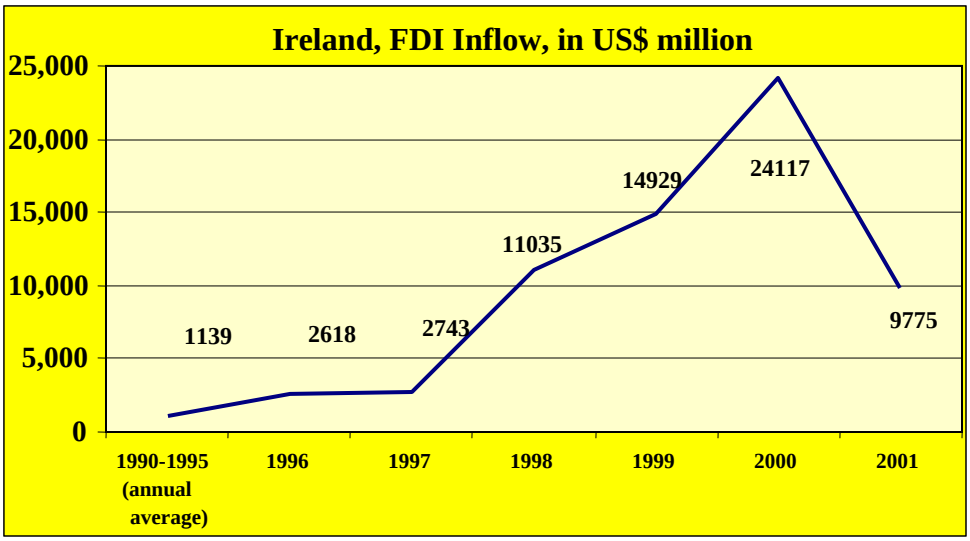
In the mid-80s, Ireland changed the strategy of attracting FDIs in a way that it focused on attracting TNCs which operate in the fastest-growing industries of the world economy: electronics and the pharmaceutical industry. Irish IDA has a colossal budget – e.g. EUR 164 million for granting loans and benefits for new investments and EUR 27 million for promotion and administration in 2001.

In the development strategy, investment incentives were complementary with efforts to improve the economic foundations of the Irish economy. Profits from exports were tax-free at first. As of 1981 they introduced taxation of profits of companies in the area of industry and certain services, as well as of companies located in the international financial center or the Shannon area of free trade. Current investments will be levied at the rate of 10% until 2010, and as of this year a universal taxation rate of 12.5% will come into effect.

The Irish government also put extraordinary efforts into education and additional training of the workforce in order to make the country more attractive for investments. The share of students in the total population increased from 2.6% in the late 80s to 3.7% ten years later. With regard to this indicator, Ireland is among the top countries in the world[18]. Brain-hunting has been used for covering the deficit in the higher qualifications with the highest demand.

In line with the active approach of the Government and IDA, in the late 90s Ireland recorded an investment boom. The FDIs inflow reached US$ 24 billion in 2000, as compared to average annual values of about US$1.1 billion in the first half of 1990s. Cumulative inflow of FDIs increased from US$ 9.6 billion in 1995 to US$ 74.8 billion in 2001.

[18] The greater share of students in the total population in the late 90s was recorded in Canada (5.8%), Austria (5.7%), Republic Korea (5.6%), the USA (5.2%), Taiwan (4.9%), New Zealand (4.5%), Finland (4.4%), Spain (4.3%) and Norway (4.2%).



Lessons for Serbia

Certain conclusions can be drawn from the experience of Ireland, which may be beneficial for the coming period of economic recovery and development of Serbia.

- The policy of selling odds and ends should be abandoned to accept the reality that we must specialize in specific industries where we are able to achieve international competitiveness.
- Short-term priority should be the resolution of administrative problems which are an obstacle to development of entrepreneurship, turning potential investors away, and to simplify procedures and establish clear "rules of the game".
- We should achieve the most demanded know-how through the educational system, prequalification and additional training of adults.
- Tax incentives; a customs-free regime for imports that are used as inputs in exporting products, lower tax rates and tax exemptions for reinvested profits.
- A clear developmental strategy expressed through the tariff system, the fiscal system and the government's policy.

During the last 15-20 years, the leading theorists for international economics and economic development developed the theory of "bounding growth" which occurs in undeveloped countries that become a part of the developed world. Namely, independent of the amount of inputs produced (work, capital and technology), economic development occurs at a very rapid pace in a limited number of underdeveloped countries on the outskirts of the developed world. Thus, Japan recorded spectacular growth during the 50s and 60s, "the Asian Tigers" during the 70s and 80s, Ireland, Mexico, China, Vietnam, Thailand and Philippine during the 90s. On the basis of the data on GDP growth, exports and FDI inflow,

it seems that the countries of Central and Eastern Europe are due to experience the becoming a part of the developed world at the beginning of the 21st century. This means that Serbia will miss a historic opportunity which has now become open if it continues to deal with its own irrational problems, instead of putting all efforts into taking advantage of this opportunity.

Department for European Issues

THE EU REVIEW

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EUROPEAN INTEGRATION PARTNERSHIP

One month before the beginning of the European Union – Western Balkans Summit, which is scheduled for June 21, 2003 in Thessalonica, the EU has taken initiative for this meeting to be as successful as possible. Namely, in order to strengthen relations between the countries of the Western Balkans and the Union, the European Commission, on May 21, approved the Proposal titled "The Western Balkans and European Integration" in the EU Council and the European Parliament.

This Proposal foresees the extension of current policies towards the Western Balkan region, which, according to the Union's definition, is composed of Croatia, Bosnia and Herzegovina, Serbia and Montenegro, Macedonia and Albania. The policy towards this region, which was established through the Stabilization and Association Process, should be supplemented with some elements from the accession process applied to CEE countries, aimed at the achievement of the ultimate goal – i.e. membership of these countries in the EU – in the shortest possible time. The Stabilization and Association Process will remain the main instrument of relations between the Union and the region, but it is given a new dimension by adding elements that have proved successful with candidates for EU membership. Chris Patten, Commissioner for External Relations, gave the best explanation of the need and significance of such a proposal, by saying that "…the map of the EU will not be complete until the countries of the Western Balkans are included in it. There is a great deal of work to be done: reforming the economies, standards of governance and democracy of the region remain major challenges – alongside the constant battle to tackle corruption and organized crime. What we are proposing today shows that the EU will do all it can to help these countries prepare themselves and that our wish to see them one day as fellow members is real".

As a matter of fact, this Proposal is the Commission's response to the question of how the experience from former accessions can be used and developed, as well as its attempt to define what can be considered a joint agenda for European integration. The Proposal still insists on the preservation of efforts in the realization of priorities which are considered important in the Stabilization and Association Process, in order for criteria for membership in the EU to begin to be met. What

the Commission actually tends to achieve is sustaining of progress of reforms in these countries, and as such, to serve as a basis for further progress. However, this will not be sufficient – in order to join further integration processes, these countries need to move beyond reconstruction and recovery during the political and economic transition, as well as to start getting closer to the legal norms of community law.

The Commission considers the need to develop strong and functional states which will be capable of meeting expectations of their citizens, facilitate regional cooperation and further the relations with the Union, to be the great challenge for the countries of the Western Balkans. Therefore the Commission stresses that "…priority must be given to the fight against organized crime and corruption – progress in this area is fundamental for ensuring the rule of law, for building confidence into state institutions and generation of private institutions, and for getting closer to membership in the EU. The attainment of this goal will be subject to political will and capability of the countries in question, as well as to their readiness to harmonize with European standards and values".

How does the Commission plan to help these countries on their path to the EU, given that the Annual Report on the Stabilization and Association Process (March 2003) confirmed the progress made by countries included in the process, but at the same time pointed to significant shortcomings in the implementation of reforms, especially with regard to the functioning and capacities of public institutions, the rule of law and the problems of organized crime and corruption. Taking precisely these elements into consideration, the Commission proposed to the Council to set up the ***European Integration Partnership*** for the Western Balkan countries.

This Partnership is inspired by the pre-accession phase of enlargement, i.e. the process of preparation for membership, and its main task is to identify priorities for action in preparation for closer integration with the EU. The priorities will be based on political and strategic priorities of the Commission, on the basis of assessment made in the Annual Reports, while concurrently monitoring fulfillment of the Copenhagen criteria (1993) and of special conditions for the Western Balkans (1997). As a matter of fact, the main objective of this Partnership is to identify reforms, both long-term and short-term, which these countries should carry out. The identification of what are the necessary reforms should help in two ways: firstly, to serve as a test for assessing individual progress of countries in question, and secondly, to set guidelines for earmarking financial assistance through the CARDS program. Special emphasis is put on the fact that this concerns monitoring of individual stages of development of each country, while guidelines should be created in accordance with the specific needs of each of them.

This practically means that each Western Balkan country should respond to this Partnership by developing and applying its own Action plan, which would define a timetable and details of realization of the priorities identified by the Partnership. On the other hand, the Commission monitors progress made in the implementation of the Partnership through offices set up on the basis of the Stabilization and Association Agreement (for countries that have already concluded this Agree-

ment) or on the basis of regular political dialogues, while findings will be presented through regular annual reports.

Support for Institution Building

Besides the European Integration Partnership, the Commission proposed some other measures that might be of assistance in particular segments of transition in the countries of the Western Balkans, applying practices that have shown their worth in the preparation of the current Enlargement. As assistance and support in institution building, the Commission proposed the introduction of so called "twinning programs", the transfer of administrative skills, i.e. the sending of public servants from EU Member States to work as advisers at the institutions of the Western Balkan countries. Actually, public servants from different ministries of EU Member States (both new and old), depending on the needs, will be sent as expert assistance to the Western Balkans; they will help their counterparts in relevant ministries very operationally and functionally, not only in the process of establishing EU standards, but also in the much more difficult process of organization of administration necessary for achieving this goal efficiently. Such projects have already been foreseen by the CARDS program in October 2002; twinning programs have already begun in Albania and Croatia, and should be developed further to extend to other Western Balkan countries.
Another program that will become available to the countries of the Western Balkans is TAIEX, i.e. Technical Assistance Information Exchange Office. The Commission introduced this program in order to provide directed technical assistance to candidate countries in the realization of *acquis*, and monitoring and assessment of the legal systems of candidate countries. Of course, realization of the TAIEX program for the Western Balkans through this Office is designed to meet the needs of this region. The results of the legal system assessment should become an integral part of each future annual report of the Commission, but at the same time, they will be the basis for periodic revisions of the European Integration Partnership.

Economic Development

Besides political dialogue, each Association Process is essentially based on the realization of four basic freedoms (free movement of goods, people, services and capital), i.e. on free trade. This is also the case with the Stabilization and Association Process, where, as the Commission stressed, trade is considered to be "a foundation stone". Although countries in the region increased their exports to the Union and stimulated their mutual trade through the network of bilateral trade agreements, it turned out that they need help in order to make the best use of trade benefits granted to them by the Union.
On the other hand, the Union insists on establishing a free trade area in the region in the medium term, which would bring these countries additional benefits from liberalization. To achieve this goal the Commission proposed to extend the system of pan-European diagonal accumulation of origin to these countries. In-

clusion of these countries in this system (of course, not all of them and not immediately, as they need to fulfill the necessary conditions), which guarantees a certain standard and quality of products, would strengthen trade in the region, thus supporting economic development. Another significant result, as assessed by the Commission, would be increase in their mutual cooperation and mutual trust, which would support the general objective of the entire Stabilization and Association process.
Furthermore, as assistance in furthering economic development, the Commission puts emphasis on the improvement of business climate for small and medium-sized enterprises due to the significance of such enterprises in the process of transition of the economies of the Western Balkan countries. Therefore the countries of the Western Balkans have been invited to commit to the principles of the European Charter for Small Enterprises in order to exchange experiences with other European states. On the other hand, the Commission proposed regular economic dialogue with each of these countries separately, which would serve as an instrument for finding the answer to these and all other questions related to economic progress of the Western Balkans.

Financial Assistance and Regional Cooperation

The main financial instrument of the Union's assistance in the Stabilization Process is the CARDS program, which will continue to realize its task. The Program began as support for the reconstruction and building of these states, but its main task today is actually institution and administrative capacity building, and assistance to justice and home affairs. What the Commission suggests in that respect is not the change of the CARDS's mandate (such a change, in terms of finding the response to regional needs is yet to be made), but increase in the program's budget, as well as the exceptional possibility of granting macro financial assistance to these countries.
The countries of the Western Balkans are encouraged "to take ownership of the regional cooperation", and the fact that this is possible is shown through initiatives such as the Cooperation process in South Eastern Europe, which was created and which has been implemented in this region. Cooperation through the Stability Pact is also supported in the area such as refugee return, migrations, freedom of movement, trade and investments; cross border cooperation with Union's Member States is also encouraged.

Other Proposals

The Commission proposed to develop dialogue with the Western Balkan countries with the aim of establishing realizable, measurable and real parameters for the assessment of progress in the area of justice and home affairs, as an essential element in its support to the rule of law. These parameters will, further, become priorities in that area and they will be observed and developed through the European Integration Partnership. Migration policy in general, and visa regimes

in particular, are another priority, and the Commission foresees stronger assistance programs for these areas, also.
According to the Commission's proposal, Western Balkan countries should be included in EU programs, in particular in the area of education, VET and energy, and the participation of these countries would facilitate their becoming familiar with the Union's policy and methods of work, which would, again, contribute to their preparation for establishing closer relationship with the EU. Of course, these countries would not be able to join the existing programs immediately; the Commission has left some room in order to examine legal and financial aspects, and ways of including these countries in the Union's programs.
As far as narrower political proposals are concerned, the Commission especially insists on strengthening parliamentary collaboration, in particular on the establishment of relations between parliamentary committees for European issues. Its concrete proposal is to establish contacts at the regional level by creating one body which the Commission titled the Balkan Conference of Parliamentary Committees for European Issues; this would make it possible for national parliaments of the EU Member States and of the Western Balkan countries, as well as for the European parliament, to develop regular dialogue on issues related to the EU.
The Commission's proposal to partially include Western Balkan countries into the Common Foreign and Security Policy of the Union, of course, not in the policy creation process, but more as a support to its implementation, is very interesting. These countries would be included by invitation to join declarations, common positions and other decisions within the framework of this policy, which could "strengthen the process of harmonization of priorities and make them closer to the EU in the political sphere".

The Summit in Thessalonica

All proposals related to the Western Balkans, not only those initiated by the Commission, will become a part of the preparation and realization of the Summit in Thessalonica. Great expectations are inherent in this Summit. This proposal shows that not only are the countries included in the Stabilization and Association Process preparing to appear as proactive as possible in relation to the Union, individually, but also as a group. The Proposal shows us that these countries are seriously considered not only as candidates, but also as partners in their coming closer to the Union. It is precisely the Commission's proposal thus defined which presents significant success lobbying thus far of the Western Balkan countries which have been tending for some time to apply some pre-accession instruments. On the other hand, they failed in what they wanted most: access to regional funds which would mean great financial assistance to reforms in these less developed countries. The Commission's proposal does not mention utilization of structural or cohesion funds of the Union for these needs. Because of this, the Summit in Thessalonica will be the place where Western Balkan countries will have to negotiate new instruments of financial assistance in order to become

really equal partners to the European Union in the best possible way and in the shortest possible time.

Economic News

Annual Program for Serbia and Montenegro

The European Commission adopted its Annual Program for the state of Serbia and Montenegro for 2003. Within the CARDS program (Community Assistance for Reconstruction, Development and Stabilization Program), the Commission earmarked EUR 229 million for Serbia and EUR 13.5 million for Montenegro to support reforms and modernization efforts for good governance, economic reconstruction and the development of civil society.
EUR 229 million allocated for Serbia are projected for the following priorities and activities: economic reconstruction, regeneration and reforms (EUR 141 million), good governance and institution building (EUR 59 million), social development and civil society (EUR 24 million) and other (EUR 5 million).
EUR 141 allocated for economic reconstruction and reforms are organized according to the following activities:

- Energy (EUR 69 million) – support for the major overhaul of thermal power plants Nikola Tesla A5 and B1 and training programs and the introduction of the culture of modern management at the EPS.
- Environment (EUR 12.5 million) – aimed at strengthening environmental standards by developing the necessary institutions and legislation, including preparation of national and local environmental action plans.
- Transport (EUR 4.5 million) – aimed at speeding up economic development and facilitating transport through Serbia and Montenegro by supporting feasibility studies for the following projects: (i) Belgrade City Bypass; (ii) Belgrade to Montenegro road; and (iii) Inland Waterways' Master Plan.

The sum allocated for economic development is organized in the following way:

- Local / Municipal Development (EUR 35 million) – support for the decentralization of state authority by enhancing the delivery of municipal services and by strengthening the ability of municipalities to design and implement local development initiatives.
- Privatization and Enterprise Development (EUR 13.5 million) – assistance in the privatization of state-owned and socially-owned companies and boosting of economic development, encouraging the decentralization of the Privatization Agency. This also includes assistance in establishing an "expert fund", which will finance an in-house ream of privatization advisers. A significant activity refers to the rebuilding a businesses culture in Serbia by supporting the EBRD-based "Turn-Around Managements" (TAM) Group to assist in the reconstruction of about 25 enterprises. The Program will encourage the economic and social cohesion of the popula-

tion by promoting regional development strategies, aiming to improve employability, market access and social development. It will also help export growth and the return of Serbia to international markets, by increasing the activities of the Serbian Investment and Export Promotion Agency (SIEPA), as well as by helping selected enterprises that can demonstrate export potential.

- Rural development / Agriculture (EUR 7 million) – aimed at ensuring food safety and the well-being of livestock, and at boosting food exports by improving the effectiveness of sanitary, phyto-sanitary and veterinary inspections.

The sum allocated for Good Governance and Institution Building (EUR 59 million) is planned to be spent on following:

- Public Finance Management (EUR 28 million) – promotion of greater effectiveness in public finance and more transparency and greater accountability in the use of public funds by providing equipment and training to the Public Revenue Agency, the Ministry of Finance and the Economy, etc.
- Justice and Home Affairs (EUR 13 million) – aimed at empowering the law enforcement agencies and courts to combat cross-border and domestic organized crime by offering training and equipment to the border police, to the Belgrade Police, to the Prosecution Office and to the Ministry of Interior.
- Reform in the Public Health Sector (EUR 9.5 million) - assistance in the reform of the health sector, providing advice on policy and planning at the Ministry of Health and other key medical bodies, in order to create a national integrated public health strategy and an action plan for its implementation.
- European Integration (EUR 9 million) – aimed at helping Serbia and Montenegro meet their obligations in the Stabilization and Association Process by taking steps to approximate local standards to those of the EU.
- Customs and Taxation (EUR 5 million) – continued assistance in modernization and development of the customs services of the state and its constituent republics, and at ensuring coordination between customs and taxation authorities.
- Public Administration Reform (EUR 2 million) – aimed at ensuring a more efficient and effective public administration by assisting in the reorganization and establishment of a training center at the Ministry of State Administration.

Funds allocated for Social Development and Civil Society in the total amount of EUR 24 million will be directed towards the following activities:

- Vocational Education and Training (EUR 13 million) – contribution to the economic development and social stability of Serbia, by developing its capacity to run national vocational education and adult training, that aim to get people back to work. This program also includes the upgrade of such facilities as workshops and laboratories, and assistance to the European Investment Bank in preparing, tendering and monitoring investments in the education sector.

- Media (EUR 6 million) – promotion of independent media by strengthening the role of those outlets most capable of adapting to the new market conditions, in particular the Media Center and B92 (a major independent electronic media), as well as further transformation of RTS into an independent and financially sustainable public broadcasting service.
- TEMPUS (EUR 4 million) – this program will continue to develop joint inter-university projects, as well as individual mobility of university experts.
- Civil Society (EUR 1 million) – assistance in the reduction of poverty by establishing a fund that brings government and NGOs together in order to help the most vulnerable.

The reminder of the money (EUR 5 million) is classified as “other”, and will be used to cover currently unforeseeable program related expenditures, and as a General Technical Assistance Facility.

The amount of EUR 13.5 million, allocated on the basis of the Annual Program for Montenegro, is related to the following areas: Economic Reconstruction, Regeneration and Reforms (EUR 7.5 million), Good Governance and Institution Building (EUR 4 million), Social Development and Civil Society (EUR 1.5 ,million) and other (EUR 0.5 million).

The funds allocated for Economic Reconstruction, Regeneration and Reform (EUR 7.5 million) will be spent as follows:

- Environment (EUR 4 million) – protection of the environment, both along the coastline and inland, by preparing an investment program for improving the treatment of waste-water and disposal of solid waste. This program will also help the development of a strategic plan that introduces EU environmental standards and aims at attracting substantial foreign direct investments.
- Energy (EUR 2 million) – aimed at increasing energy efficiency and meeting the demand for electricity by continuing to support the power companies.
- The sum allocated for economic development (EUR 1.5 million) will be directed towards rural development / agriculture. This program includes the improvement of livestock and horticultural production, and protection of human health by strengthening disease surveillance that includes establishing of investigative laboratory facilities.

Funds allocated for Good Governance and Institution Building (EUR 4 million) are organized as follows:

- Justice and Home Affairs (EUR 3 million) - the development of an efficient and professional judiciary by organizing training for judges and by providing equipment to the courts.
- Customs and Taxation (EUR 1 million) – assistance will focus on supporting managers of the customs and taxation services in the implementation of a long-term modernization and development strategy.

Funds earmarked for Social Development and Civil Society (EUR 1.5 million):

- Support to Civil Society and Media (EUR 1.5 million) –assistance in developing a fair and democratic society by strengthening the role

of NGOs by providing grants and offering management and support initiatives aimed at NGOs dealing with socio-economic and environmental issues.

- TEMPUS (EUR 0.5 million) – This program will continue to develop joint inter-university projects and individual mobility.

Finally, the item “other”, in the amount of EUR 0.5 million, as in Serbia, will be used to cover currently unforeseeable program related expenditures and as a General Technical Assistance Facility.

Source: “Midday Express”, http://europa.eu.int/comm/press_room/index_en.htm